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Another Perfect Storm

Treacherous Waters: Handling Claims Brought Pursuant to the Civil and Criminal False Claims Acts

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Introduction

In the everyday commercial world of construction contracting, it is not uncommon for contractors to "front load" the milestone payment schedule; to submit "inflated" claims for negotiation purposes; to substitute materials; or change the work and fight about the difference when the project is complete. Although such actions may lead to disputes and civil lawsuits between the parties, they do not have the same civil and criminal liabilities that these very same actions would have in the world of public construction contracting. For the construction lawyer who is unfamiliar with the pitfalls of public construction contracting it is important to know the laws and regulations that govern these contracts, and the broad range of conduct that is potentially actionable under the False Claims Act ("FCA") and other similar anti-fraud statutes.[1]

Recent FCA and other public fraud cases involving construction contractors, and increased emphasis by the Government on compliance, detection, and punishment of fraud in public procurement, led the ABA Forum on the Construction Industry to publish a book for construction lawyers on this topic. *False Claims in Construction Contracts: Federal, State, and Local* addresses both the civil and criminal false claims statutes, as well as related anti-fraud statutes. The topics covered include:

Chapter 1: A History of Enactment and Significant Amendments to the False Claims Act by Lynn Patton Thompson

Chapter 2: Contractor and Subcontractor Liability Under the False Claims Act by Peter B. Hutt, II

Chapter 3: Owner, Design Professional, and Construction Manager Conduct Giving Rise to Civil False Claims Act Liability by Edmund V. Caplicky, III

Chapter 4: Introduction to Damages and Penalties by Peter B. Hutt, II

Chapter 5: *Qui Tam* Actions Under the False Claims Act by Claire M. Sylvia

Chapter 6: Retaliation Claims Under Section 3730(h) by Brian A. Hill

Chapter 7: Defending a Civil False Claims Act Case: Practice Considerations by Patrick Greene Jr. and Frank A. Hess

Chapter 8: Resolution of False Claims Act Cases by Stephen D. Altman

Chapter 9: Corporate Compliance and Ethics Programs for Construction Enterprises by William W. Thompson, Jr.

Chapter 10: Federal Criminal Prosecution for False Claims by Howard O'Leary and Krista L. Pages

Chapter 11: Survey of State False Claim Liability by Deborah S. Ballati and Christopher D. Montez

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[1] 31 U.S.C. *et seq.*

This plenary session touches generally on some of the topics discussed in detail in *False Claims in Construction Contracts: Federal, State, and Local.* We have included Chapter 10, Federal Criminal Prosecution for False Claims from the book. The following is a brief overview about the FCA.

Background

A. Grounds for Liability under the Civil False Claims Act

FCA Sections 3729(a)(1) and 3729(a)(2) present the most common grounds of liability faced by construction contractors. These sections concern similar conduct: section (a)(1) imposes liability for knowingly presenting or causing to be presented, false claims; and section (a)(2) imposes liability for knowingly using false records or statements to get false claims paid. It is possible that defendants that have presented false claims often have employed false records or statements in support of these claims so they may be in violation of both sections (a)(1) and (a)(2). The courts in determining if there has been a violation of these sections focus on the following elements: a claim; falsity; "knowing" conduct; and materiality.[2]

B. Defending a Claim under the Civil False Claims Act

Frequently the Government raises false claims allegations as a form of defense or counterclaim. To successfully defend a claim brought by the Government under the FCA, the construction lawyer must address the elements of a proper FCA claim.

In preparing defenses to an alleged violation of the FCA, counsel must determine whether the conduct forming the basis of the alleged fraud was merely negligence or an honest mistake. The FCA and other anti-fraud statutes were not intended to punish contractors for honest mistakes or mere negligence.[3] Fact finding regarding the actions that have led to the fraud allegations is essential. It is important to keep in mind that disclosure and cooperation with the government can make a significant difference in the outcome of an FCA case, especially if both the civil and criminal FCA statutes are pursued.

Defenses to FCA claims and other anti-fraud statutes may also invoke Federal Rule of Civil Procedure 9(b). This rule has been adopted by the United States Court of Federal Claims. This rule requires that in all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of the mind of a person may be averred generally.

Other defenses touch on the essential elements of the FCA. Materiality, for example, has been consistently found to be an implied element of a civil FCA action.[4] If

[2] Some courts have also required presentment of the claim to the government as a fifth element. *See* United States *ex rel. Totten v. Bombardier Corp.,* 380 F. 3d 488, 492-97 (D.C. Cir. 2004), cert. denied, 544 U.S. 1032 (2005).

[3] S. Rep. No. 99-345, at 7; 1986 U.S. C.C.A.N. at 5272).

[4] United States ex. rel. Wilkins v. North American Constr., 173 F. Supp. 2d 601, 619 (S.D. Tex. 2001).

the government had knowledge of the relevant facts underlying the alleged fraud then this will negate the element of materiality.[5]

C. Resolution of FCA and Anti-Fraud Cases

The damages the government seeks in pursuing FCA and other anti-fraud cases are often significant. The recent well-publicized case of *Daewoo Engineering and Construction Co. v. United States* dramatically illustrates this.[6] Under the FCA, violators of the statute are liable to the government for a civil penalty of not less than $5,500 and not more than $11,000, plus three (3) times the amount of damages which the government sustains because of the act of that person.[7] For example in the *Daewoo* case the contractor forfeited all of its legitimate claims when the judge found it exceeded $13 million.

Disclosure of the violation of the FCA to the government within thirty (30) days after first learning of the violation, cooperation with the government in any ensuing investigation and no prior or ongoing government investigation of the violation may be grounds for the court to reduce liability to not less than two times the amount of damages which the government sustains because of the act of the person.[8]

In addition to paying fines under the FCA for false or fraudulent claims, the contractor may also forfeit its legitimate claims for additional contract compensation under the anti-fraud provisions of the Contract Disputes Act.[9]

In addition to the federal FCA, fourteen (14) states have false claims statutes similar to the FCA. Contractors performing state work in one of these jurisdictions must be careful to follow the state anti-fraud statutes. These statutes are discussed in detail in Chapter 11 of *False Claims in Construction Contracts: Federal, State, Local.*

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[5] Neder v. United States, 527 U.S. 1, 22 n. 5.
[6] 73 Fed. Cl. 547 (2006).
[7] 31 U.S.C. § 3729 (a); 28 C.F.R. § 85.3 (9) (2000) (civil penalty limits were increased by the Department of Justice effective September 29, 1999.
[8] 28 C.F.R. § 85.3(9)(2000).
[9] *Id.*

CHAPTER 10

FEDERAL CRIMINAL PROSECUTION FOR FALSE CLAIMS

HOWARD O'LEARY AND KRISTA L. PAGES

I. Introduction

In addition to the civil False Claims Act ("FCA"), a contractor who presents a false, fictitious, or fraudulent claim to the federal government also may be subject to a criminal FCA action. Title 18 of the United States Code makes it a crime knowingly to make a false claim upon or against the United States or to any department or agency thereof.[10] In addition to a criminal FCA action, prosecutors also may act under several other antifraud statutes including: the False Statements Act,[11] Conspiracy[12], Mail Fraud,[13] or Wire Fraud.[14]

This chapter discusses both the criminal FCA and the False Statements Act and provides examples of cases where the government has indicted contractors for fraud under criminal statutes. Because charges for conspiracy, mail fraud, or wire fraud often are brought with the charges for criminal FCA and the False Statements Act, these statutes also are discussed briefly. This chapter also provides practical advice for the contractor about responding to a criminal FCA or other fraud investigation, what to do in the event of indictment and criminal prosecution, and how to set up a corporate compliance program to prevent criminal indictments.

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[10] 18 U.S.C. § 287 (2000).

[11] 18 U.S.C. § 1001 (1996).

[12] 18 U.S.C. § 286 (2006).

[13] 18 U.S.C. § 1341 (2000).

[14] 18 U.S.C. §1343. Other fraud actions that are commonly brought include: the Anti-Kickback Act (41 U.S.C. §§ 51-54 (1986), the bribery statute (18 U.S.C. § 201(b) (1994)), the Ethics in Government Act (17 U.S.C. § 207 (1996)), the Procurement Integrity Provisions (41 U.S.C. § 423 (1996)), and the Byrd Amendment (31 U.S.C. § 1352 (1995)).

As discussed in several earlier chapters, the criminal FCA and the false statements statute were covered by just one statute from 1863 to 1948. In 1948, however, Title 18 was revised. The criminal false claims provisions became 18 U.S.C. § 287, and false statements became 18 U.S.C. § 1001. The civil FCA was included in 18 U.S.C. § 3729. See Chapter 1 for a full discussion of the history of the statutory sections.

II. Elements of the Criminal Statutes

When the government believes a contractor has committed fraud in presenting a claim or making a certification to it, the government likely will use more than one of the many antifraud weapons in its arsenal to punish the contractor.[15] The decision as to what criminal indictments will be sought is driven by the facts that can be proven and the elements required. Understanding the elements of any criminal statutes being alleged is important for formulating a defense and a strategy for resolution.

A. Criminal False Claims Statute

The criminal FCA states:

> [W]hoever makes or presents to any person or officer in the civil, military, or naval service of the United States, or any department or agency thereof, any claim upon or against the United States, or any department or agency thereof, knowing such claim to be false, fictitious, or fraudulent, shall be imprisoned not more than five years (check on change to 10 years in 1986 amendment) and shall be subject to a fine in the amount provided in this title.[16]

Under 18 U.S.C. § 287, the prosecution must prove the following elements, beyond a reasonable doubt, to establish a violation: the defendant made or presented a claim to a department or agency of the United States for money or property; the claim was false, fictitious, or fraudulent; and the defendant knew that the claim was false,

[15] *See* Claude P. Goddard, Jr., *Business Ethics in Government Contracting – Part II*, Briefing Papers No. 03-7 (June 2003).

[16] 18 U.S.C. § 287 (2000).

fictitious, or fraudulent at the time the claim was made.[17] Materiality also represents an essential element in certain circuit courts. [18] The elements are set out below.

1. Presentation of a Claim

The prosecution must prove that the defendant actually presented a false claim to a department or agency of the government. "Claim" is not defined in the criminal FCA, but the civil FCA definition has been followed in criminal prosecutions to mean any "request or demand . . . for money or property" from the United States.[19] In relevant part, the civil FCA states:

> 'claim' includes any request or demand, whether under a contract or otherwise, for money or property which is made to a contractor, grantee, or other recipient if the United States government provides any portion of the money or property which is requested or demanded, or if the government will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded.[20]

The statutory language appears to require that the government receive the claim, but it does not require that the defendant present the claim directly to the government.[21] The court in *United States v. Blecker*,[22] held that presentation of the claim to an intermediary authorized to accept the claim for presentation to the government satisfied the "presentation" requirement of section 287.[23]

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[17] 18 U.S.C. § 287 (2000); *see also* United States v. Thayer, 201 F.3d 214, 222–23 (3d Cir. 1999)

[18] United States v. Snider, 502 F.2d 645, 652 n.12 (4th Cir. 1974).

[19] 31 U.S.C. § 3729(c) (2000).

[20] 31 U.S.C. § 3729(c) (2000).

[21] *See* United States v. Blecker, 657 F.2d 629, 634 (4th Cir. 1981), *cert. denied*, 454 U.S. 1150 (1982).

[22] *Id.*

[23] *Id.* The court stated "there was substantial evidence that . . . [one of the defendants] submitted invoices for hourly rates based on falsified resumes with knowledge that . . . [defendant's corporation] would seek reimbursement for the payment of the invoices from the GSA. This evidence amply supported the government's charge that . . .[defendants] violated section 287 by submitting false claims to the government through an intermediary, and we find that theory of prosecution to be consonant with the language and meaning of the false claims statute."

The criminal FCA statute does not require that the government pay or honor the claim. Thus, violations of section 287 are chargeable even if the government has not lost money because of the false or fictitious claim.[24]

2. Claim Was False, Fictitious, or Fraudulent

Charges under the criminal FCA may be based on proof that the claim submitted to the government is false, fictitious, or fraudulent.[25] A claim is false or fictitious "if untrue when made, and then known to be untrue by the person making it or causing it to be made."[26] A claim is fraudulent "if known to be untrue and if made or caused to be made with the intent to deceive the government agency to whom submitted."[27]

3. Knowledge – Intent – Willfulness

The criminal FCA requires the prosecutor to prove that a false claim against the government was made, "knowing such claim to be false, fictitious or fraudulent."[28] The government does not have to allege willfulness in the indictment because the term "willfully" is not included in section 287 and the courts have not held that it is an "essential element."[29] The circuits vary on the proof of intent necessary to convict for a violation of the criminal FCA. For example, the Fourth Circuit approved a jury instruction stating that under section 287, criminal intent "could be proved by either a showing that the defendant was aware he was doing something wrong or that he acted with a specific intent to violate the law."[30] The Ninth Circuit[31] held that no instruction on

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[24] United States v. Miller, 545 F.2d 1204, 1212 n.10 (9th Cir. 1976), *cert. denied*, 430 U.S. 930 (1977).

[25] United States v. Murph, 707 F.2d 895, 897 (6th Cir. 1983), *cert. denied*, 469 U.S. 821 (1984) ("the government may prove and the trial judge may instruct in the disjunctive form used in the statute").

[26] 18 U.S.C. § 287 (1986).

[27] United States v. Milton, 602 F.2d 231, 233 n.6 (9th Cir. 1979) (quoting 2 E. DEVITT & BLACKMAR, FEDERAL JURY PRACTICE AND INSTRUCTIONS § 28.04 (3d ed. 1977)).

[28] 18 U.S.C. § 287 (1986).

[29] United States v. Irwin, 654 F.2d 671, 682 (10th Cir. 1981), *cert. denied*, 455 U.S. 1016 (1982).

[30] United States v. Maher, 582 F.2d 842, 847 (4th Cir. 1978), *cert. denied*, 439 F.2d 1115 (1979).

[31] United States v. Milton, 602 F.2d at 234.

"intent to defraud" is necessary where a false claim is charged (because it is not an element of the offense), but it left open whether an "intent to deceive" is an element of a charge of submitting "fraudulent" claims.[32] The Eighth Circuit[33] did not distinguish between false and fraudulent claims, but held without elaboration that section 287 requires proof of criminal intent.

4. Materiality

The criminal FCA does not specifically require that a claim be false as to a "material" matter, but the Circuits are split on whether materiality is an essential element. The Second and Tenth Circuits have held that materiality is not a requirement of section 287 and need not be alleged in an indictment charging a statutory violation.[34] The Fifth and Eighth Circuits have held that, even assuming materiality is an element of the crime, it is an issue "for the trial judge to handle as a question of law."[35] The Fourth Circuit has stated that materiality is an element of section 287.[36]

The test for materiality, as set out by the circuit courts that have found it to be an element, is "whether the falsification is calculated to induce action or reliance by an agency of the United States, one that could affect or influence the exercise of government functions, a natural tendency to influence or is . . . capable of influencing [an] agency decision."[37]

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[32] Milton, 602 F.2d at 233 n.7.

[33] Kercher v. United States, 409 F.2d 814, 817 (8th Cir. 1969).

[34] United States v. Elkin, 731 F.2d 1005, 1009 (2d Cir.), *cert. denied*, 469 U.S. 822 (1984); United States v. Irwin, 654 F.2d 671, 682 (10th Cir. 1981), *cert. denied*, 455 U.S. 1016 (1982).

[35] United States v. Haynie, 568 F.2d 1091 (5th Cir. 1978); United States v. Pruitt, 702 F.2d 152, 155 (8th Cir. 1983).

[36] United States v. Snider, 502 F.2d 645, 652 n.12 (4th Cir. 1974).

[37] United States v. Pruitt, 702 F.2d 152, 155 (8th Cir. 1983); United States v. Adler, 623 F.2d 1287,1291 (8th Cir. 1980).

B. False Statements Statute

The false statements statute is another popular antifraud statute available to the government and often is included with an indictment under the FCA because the making of a false claim also involves making a false statement. This statute makes it a crime knowingly and willfully to make a false statement to the United States or any department or agency thereof.[38] Section 1001 includes three broad categories of offenses: falsifying, concealing, or otherwise covering up a material fact by any trick, scheme, or device; making materially false, fictitious, or fraudulent statements or representations; and making or using a writing or document with knowledge that such document contains materially false, fictitious, or fraudulent statements.[39]

The government must prove five elements of a false statement offense under section 1001. These elements are: the defendant made a statement or concealment; the statement was false; the statement or concealment was material; the statement or concealment was made "knowingly and willfully"; and the statement or concealment falls within executive, legislative, or judicial branch jurisdiction.[40] Each requirement is discussed below.

1. Statements or Concealments

The False Statements Act covers all statements, whether oral or written, sworn or unsworn, voluntary or required by law.[41] Section 1001 also applies to affirmative acts of concealment even where no actual statement has been made.[42] Affirmative acts include

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[38] 18 U.S.C. § 1001(1996).

[39] *Id.*

[40] Brogan v. United States, 522 U.S. 398, 400 (1998) (provides an outline of the elements of section 1001).

[41] *Id.* at 417–18 (Souter, J., concurring) (discussion of distinctions in oral, written, sworn and unsworn statements).

[42] United States v. Curran, 20 F.3d 560, 566 (3d Cir. 1994).

nondisclosures and misrepresentations of material fact as well as the concealment of information with the intent to deceive the government.[43]

2. Falsity

Falsity may be proved by the prosecution through either an affirmative false representation or the concealment of a material fact. To demonstrate this element, the government must show a non-disclosure of a fact through a "trick, scheme, or device."[44] However, where the defendant makes an affirmative false representation, no trick, scheme, or device need be proved.[45]

3. Materiality

In 1996, Congress amended section 1001 to add a materiality requirement. The language was changed to ensure that defendants would not be held liable for trivial falsifications.[46] Courts have held a statement to be material if it either actually influences a federal agency or has a natural tendency or capacity to influence a decision or function of a federal agency.[47] The government need not have actually believed or even received the false statement for the materiality requirement to be met.[48]

4. Intent

Knowing and willful intent is a necessary requirement for a violation of the False Statements Act to be found. "'Intent' under section 1001 encompasses the intent to deceive, mislead, or induce belief in the false information.[49] Intent to defraud need not be

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[43] United States v. Leal, 30 F.3d 577, 585 (5th Cir. 1994); United States v. Hubbell, 177 F.3d 11, 12 (D.C. Cir. 1999).

[44] 18 U.S.C. § 1001; *see* United States v. St. Michael's Credit Union, 880 F.2d 579, 589 (1st Cir. 1989) (holding that "trick, scheme or device" language requires an "affirmative act of concealment").

[45] United States v. Woodward, 469 U.S. 105, 108 n.4 (1985) (per curiam).

[46] H.R. Rep. No. 104-680, at 8 (1996) (Comm. On the Judiciary) (clarifying that materiality is an element of all three of the section 1001 types of violations).

[47] *See* United States v. Gaudin, 515 U.S. 506 (1995).

[48] *See*, *e.g.*, United States v. Sarihifard, 155 F.3d 301 (4th Cir. 1998).

[49] Jeremy Baker & Rebecca Young, *Twentieth Survey of White Collar Crime: Article: False Statements and False Claims*, 42 AM. CRIM. L. REV. 427, 436 (2005).

proved; "reckless disregard of the truth" will satisfy the intent element.[50] The "defendant can have the requisite intent even if he or she is unaware of the potential consequences of making a false statement."[51]

5. Jurisdiction

Jurisdiction has a broad definition. The government has jurisdiction to prosecute a false statement when the request for information falls within the general authority of the requesting department or agency from any of the three branches of government. Jurisdiction exists even if the government has not lost money or property as a result of the false statement. False statements to a state agency also may result in a prosecution if the federal government has jurisdiction over the state in that matter. For example, if federal funds are being used by the state for the project. It is not difficult for the government to prove that a statement has been made. The government often uses, for example, the contract certifications, progress payment requests or invoices, statements made to government investigators, submission of test reports, and submission of cost or pricing data to prove the statement on a particular matter.

C. Conspiracy

Conspiracy also may be alleged by the prosecution along with the FCA and False Statements Act. Section 286 of Title 18 provides that:

> Whoever enters into any agreement, combination, or conspiracy to defraud the United States, or any department or agency thereof, by obtaining or aiding to obtain the payment or allowance of any false, fictitious or fraudulent claim, shall be fined under this title or imprisoned not more than ten years, or both.[52]

To convict the defendant under the section 286 conspiracy statute, the government must prove beyond a reasonable doubt that: there was an agreement, combination, or

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[50] *Id.* at 436–37.
[51] *Id.*
[52] 18 U.S.C. § 286 (2000).

conspiracy to defraud the United States and that the defendant sought to obtain or aid another in obtaining the payment of any false, fictitious, or fraudulent claim. The government must show that the defendant agreed to engage in a scheme to defraud the government and knew that the objective of the scheme was illegal. In *United States v. Lanier*,[53] the court held that the government need not charge or establish an overt act in furtherance of the conspiracy to prove a violation of section 286.

The government also must prove that the conspirators agreed to defraud the government by obtaining the payment of false claims against the government. As with the FCA and false statements statute, the government need not actually have paid the conspirators. No requirement exists that the conspirators actually took steps to obtain payment, it is enough to prove that they agreed to file a false claim.

Prosecutors also may use the general federal conspiracy statute. Section 371 of Title 18 provides that:

> If two or more persons conspire either to commit an offense against the United States or to defraud the United States, or any agency thereof in any manner or for any purpose, and one or more of such persons do any act to effect the object of the conspiracy, each shall be fined under this title or imprisoned not more than five years, or both.
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> If, however, the offense, the commission of which is the object of the conspiracy, is a misdemeanor only, the punishment for such conspiracy shall not exceed the maximum punishment provided for such misdemeanor.

Section 371 reaches two separate types of criminal conduct: first, conspiracies to commit offenses that violate specific federal statutes, e.g., conspiring to cause the submission of false statements; and, second, conspiracies to defraud the United States. The prosecution need not show any loss of money or property to the government to establish a conspiracy in violation of the second prong of the statute as long as the

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[53] 920 F.2d 887, 892 (11th Cir.), *cert. denied*, 112 S. Ct. 208 (1991).

purpose of the conspiracy was to impair or obstruct some lawful governmental function. The term "defraud" encompasses much more conduct under section 371 than that which the federal mail and wire fraud statutes reach.[54]

To prove a violation of section 371, the government must show beyond a reasonable doubt that: two or more persons entered into an agreement to pursue an unlawful objective, that each defendant knowingly and willfully "joined" or became a member of the conspiracy, and that one of the conspirators knowingly committed an overt act in furtherance of the conspiracy's objective.

Although the two statutes overlap because both prohibit agreements to defraud the government, their wording also makes clear several differences that may be important in their application to the facts of a case. Section 286 is narrower; it applies only when the conspirators agree to defraud the government in a specific manner: "by obtaining the payment or allowance of any false, fictitious, or fraudulent claim."[55] Section 371, by contrast, reaches agreements to defraud the government without regard to the particular means chosen by the conspirators to carry out their agreements.[56] "Perhaps because the submission of false bills is particularly difficult to detect and, therefore, more likely to succeed, Congress has provided a longer maximum prison term under section 286 (ten years) than it has under section 371 (five years)."[57]

D. Mail Fraud

In some cases, the prosecutor in bringing charges for violation of the FCA and/or False Statements Act also may charge the defendant with mail fraud under 18 U.S.C. § 1341. In many cases, the false claims made by the defendant contractor or

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[54] HAAS v. Henkel, 216 U.S. 462 (1910).
[55] 18 U.S.C. 286 (2000).
[56] 920 F.2d 887, 892 (11th Cir.), *cert. denied*, 112 S. Ct. 208 (1991).
[57] *Id.*

subcontractor are included in written payment requests or claims mailed to the government. The mailing of such false claims constitutes a violation of the mail fraud statute, which provides in relevant part:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, . . . for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Postal Service, or deposits or causes to be deposited any matter or thing whatever to be sent or delivered by any private or commercial interstate carrier, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail or such carrier . . . shall be fined under this title or imprisoned not more than 20 years, or both.[58]

The government must prove two elements in mail fraud: having devised or intending to devise a scheme to defraud (or to perform specified fraudulent acts) and use of the mail for the purpose of executing, or attempting to execute, the scheme (or specified fraudulent acts).[59]

The government need not prove that the defendant actually mailed or transported anything themselves in furtherance of the scheme, it is sufficient if they simply caused it to be done.[60]

E. Wire Fraud

If the fraud is not carried out through the mail but instead through bank wire or other electronic transfer of funds from the government, the prosecutor may include a count for violation of 18 U.S.C. § 1343. The wire fraud statute provides:

> Whoever, having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, transmits

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[58] 18 U.S.C. § 1341 (2000).

[59] Pereira v. United States, 347 U.S. 1, 8 (1954); *see also* Laura A. Eilers & Harvey B. Silikovitz, *Mail and Wire Fraud*, 31 AM. CRIM. L. REV. 703, 704 (1994).

[60] 18 U.S.C. (Supp. V) § 2314.

> or causes to be transmitted by means of wire, radio, or television communication in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such scheme or artifice, shall be fined under this title or imprisoned not more than 20 years, or both.

The elements of wire fraud are the same as mail fraud, but require the use of an interstate telephone call or electronic communication made in furtherance of the scheme instead of the mail.[61] The four essential elements of wire fraud are: that the defendant voluntarily and intentionally devised or participated in a scheme to defraud another out of money; that the defendant did so with the intent to defraud; that it was reasonably foreseeable that interstate wire communications would be used; and that interstate wire communications in fact were used.[62]

The government must prove that the defendant knowingly and willfully participated in the scheme to defraud and that the scheme involved the means of interstate commerce. The government need not show that the defendant was the one who carried out the scheme or made misrepresentations to the government.[63]

III. Contractor Conduct Giving Rise to Criminal FCA, False Statement Act Liability, and Other Criminal Fraud Statutes

Although there are not as many reported cases of violation of the criminal FCA, False Statement Act, and other fraud statutes by construction contractors, as compared to health care providers and defense contractors, the construction cases discussed below give a couple of examples of the circumstances in which contractors are prosecuted for fraud in performing federal projects. In addition, they show that contractors can be subject to both civil and criminal violations. Although there are few reported cases,

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[61] United States v. Briscoe, 65 F.3d 576, 583 (7th Cir. 1995) (citing United States v. Ames Sintering Co., 927 F.2d 232, 234 (6th Cir. 1990) (per curiam)).

[62] United States v. Profit, 49 F.3d 404, 406 n.1 (8th Cir.) (citing MANUAL OF MODEL CRIMINAL JURY INSTRUCTIONS FOR THE DISTRICT COURTS OF THE EIGHTH CIRCUIT 6.18.1341 (West 1994)), *cert. denied*, 115 S. Ct 2289 (1995).

[63] United States v. Lanire, 838 F.2d 281, 283–84 (8th Cir. 1988).

many criminal investigations of contractors occur each year.[64] Below are some examples.

A. ***United States v. Montoya***[65]

United States v. Montoya demonstrates the long reach of the federal government to prosecute criminal FCA violations even where the fraudulent claim is presented to a state government and even though the contractor does not know that it is performing work on a project whose funding comes in whole or in part from the federal government.[66]

Ricardo Montoya, doing business as the Ram Corporation, contracted with the Governor's Office of Community Affairs of the State of New Mexico to "weatherize" homes of elderly, low-income residents. Unbeknownst to Montoya, the project was funded by the U.S. Department of Energy. Montoya submitted invoices to the State of New Mexico, but none of the work had actually been completed. The federal government indicted him for criminal violations of the FCA. At his trial, a jury convicted Montoya on six counts of presenting false claims to the federal government, and he was sentenced to five years in prison on each count.

On appeal, Montoya asserted that he did not present a claim to the United States since he had contracted with and received payment from the State of New Mexico. Montoya also argued that his actions, if criminal, were only in violation of state law, since the federal government had not supervised the project. Rejecting both arguments, the Court of Appeals affirmed the conviction on the grounds that the state had received

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[64] *See, www.usdoj.gov/03press*

[65] 716 F.2d 1340 (10th Cir. 1983).

[66] *See discussion in Chapter 5 herein*, PETER B. HUTT II, CONTRACTOR AND SUBCONTRACTOR LIABILITY UNDER THE FALSE CLAIMS ACT, Part II. A. 5 "*Presentment*".

the funds from the federal government and that a "defendant's awareness that the funds would ultimately be provided by a federal agency" was irrelevant.[67]

B. *Ab-Tech Construction, Inc. v. United States*[68]

Ab-Tech Construction, Inc. demonstrates how contractors can be convicted under the False Statements Act for misrepresentations regarding small business status.

Ab-Tech was awarded a subcontract by the Small Business Administration ("SBA") for construction of a facility for the Army Corps of Engineers. Ab-Tech requested an equitable adjustment for its costs for extra work allegedly caused by defective government specifications. The claim was denied and Ab-Tech appealed to the Court of Federal Claims. Court proceedings were stayed while a grand jury investigated Ab-Tech's business affairs.[69]

The SBA and the Department of Defense Office of Inspector General found that Ab-Tech had not complied with the SBA's 8(a) minority contracting requirements. In fact, it had a silent partner, Pyramid Construction—not a minority-owned enterprise. Ab-Tech and Pyramid had entered into an "Indemnification Agreement" prior to commencing performance of construction of the Corps of Engineers facility. Ab-Tech had not revealed this relationship to the SBA (although required to do so) and had falsely certified in every pay request that it was in compliance with the 8(a) program requirements.

The investigation resulted in the criminal indictment and conviction of Ab-Tech's president on two counts of making false statements to the government in violation of the false statement statute. Ab-Tech's president was sentenced to a term of imprisonment

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[67] *Id.* at 1344; *see also* Krista L. Pages & Wesley D. Bizzell, *The False Claims Act and Other Fraud Statutes*, in FEDERAL GOVERNMENT CONSTRUCTION CONTRACTS 527 (Adrian L. Bastianelli III, Andrew D. Ness & Joseph D. West eds., 2003).

[68] Ab-Tech Construction, Inc. v. United States, 31 Fed. Cl. 429 (1994).

[69] *Id.* at 431.

and a fine of $5,000. The government also pursued and won a civil FCA action for every payment voucher submitted with the false certification.

C. Air Power Enterprises, Inc.

In January of 2006, the U.S. Department of Justice ("DOJ") announced that Nicanor Lotuaco was fined $1 million and "sentenced to five months in jail, followed by five months home detention and three years supervised release" for his involvement in fraud using false asbestos, lead, and hazardous material removal training certificates.[70] James Schaubach, ACS Environmental, Inc., and Air Power Enterprises, Inc. also were each expected to be sentenced. In addition to using false asbestos training certificates, Air Power also falsely certified itself as a small business to qualify as an SBA 8(a) program recipient.

D. Thacker Operating Company

Floyd Gary Thacker, owner of Thacker Operating Company, pled guilty to one count of "conspiracy to engage in dishonest services mail and wire fraud."[71] Thacker had been providing secret gifts, meals, and payments to garner favorable treatment for his construction company. Thacker was only one of a group of individuals who had been pursuing improper influence and were prosecuted both for wire and mail fraud, showing the overlap of those statutes and the way that they often are linked with other illegal conduct.

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[70] News Release, *Dep't of Justice, Virginia Businessman Receives Jail Sentence for Using False Asbestos Training Certificates to Obtain Contracts for Removal Jobs in Public Buildings* (Jan. 26, 2006) *available at* http://www.usdoj.gov/opa/pr/2006/January/06_enrd_038.html.

[71] News Release, Dep't of Justice, *Ninth Defendant in Multi-District Public Corruption Probe Pleads Guilty to Mail and Wire Fraud* (Jan. 18, 2006) *available at* http://www.usdoj.gov/opa/pr/2006/January/06_crm_020.html.

IV. Responding to a Criminal False Claims/False Statements Investigation

A. Introduction

Federal criminal investigations of corporations and other business entities that derive a substantial portion of their revenues from doing business with the federal government are different from other criminal investigations because of the collateral consequences of an indictment, much less a conviction. Consequently, it is crucial that the corporation or entity focus its resources on avoiding indictment either by persuading the DOJ attorneys that it did not commit the criminal act under investigation or that even if it did, criminal prosecution of the corporation would not serve the overall public interest.

A corporation is criminally liable for the acts of its employees where the person is acting within the scope of his or her employment and for the ostensible benefit of the corporation. However, if the employee involved in the criminal conduct is a relatively low level manager who violated the company's compliance program or if there are other extenuating circumstances, it may be possible—despite the entity's technical legal guilt—to persuade the DOJ to decline criminal prosecution because of the particular facts and circumstances involved.

In January 2003, Larry D. Thompson, then the Deputy Attorney General of the Department of Justice, issued a memorandum entitled "Principles of Federal Prosecution of Business Organizations" ("Thompson Memorandum") that set forth the factors that federal prosecutors are to consider in determining whether to seek an indictment of a corporation or other business entity.[72] On December 12, 2006, Deputy Attorney General Paul J. McNulty issued a new "Principles of Federal Prosecution of Business

[72] Memorandum from Larry D. Thompson, Deputy Attorney General, U.S. Department of Justice, to Heads of Department Components and United States Attorneys, Siebert: *Principles of Federal Prosecution of Business Organizations*, 3, 5–6, Jan. 20, 2003 (hereinafter "Thompson Memorandum"); FAR 9.406-1(a)(3).

Organizations" memorandum ("McNulty Memorandum"),[73] which supersedes and replaces the Thompson Memorandum. When responding to a federal criminal False Claims or False Statements Act investigation the entity and its counsel should seek to act in conformance with those factors in the McNulty Memorandum favoring declination of criminal prosecution to the extent that the facts permit.

If indictment and criminal prosecution can be avoided, any collateral proceedings, such as a DOJ civil False Claims Act ("CFCA") action and an administrative suspension/debarment proceeding often can be resolved on terms that will enable the corporation or other business entity to survive and continue doing business with the federal government. Depending on the facts and circumstances those terms may or may not involve payment of a monetary payment to resolve the entity's CFCA liability, an enhanced effective compliance and ethics program ("ECEP") and some period of debarment.

B. Defenses To Criminal False Claims Act and False Statements Act Allegations Must Be Asserted Effectively During the Investigation to Avoid Indictment and Suspension from Being Awarded Any New Federal Government Contracts

Shortly after an entity doing business with the federal government is indicted for violating the criminal False Claims Act, 18 U.S.C. § 287, or the False Statements Act, 18 U.S.C. § 1001, that entity likely will be suspended from being awarded any new government contracts and subcontracts until the ensuing criminal proceedings, and any appeals, end.[74] Federal Acquisition Regulation ("FAR") 9.407.2(a), 48 C.F.R. section 9.407-2(a) provides that a contractor may be suspended for adequate evidence of

[73] Memorandum from Paul J. McNulty, Deputy Attorney General, U.S. Department of Justice, to Heads of Department Components and United States Attorneys, *Principles of Federal Prosecution of Business Organizations*, Dec. 12, 2006 (hereinafter "McNulty Memorandum") (superseding both the Thompson Memorandum and the memorandum by Acting Deputy Attorney General Robert D. McCallum, Jr. entitled *Waiver of Corporate Attorney-Client and Work Product Protections*, issued October 21, 2005).

[74] FAR 9.407-4(a).

commission of a fraud or criminal offense in connection with performing a public contract or subcontract or for making false statements.[75] An indictment for any such offense "constitutes adequate evidence for suspension."[76] When a suspension is based upon an indictment, the suspended entity is not entitled to a fact-finding or trial-type hearing to confront its accusers and cross-examine witnesses, but it will instead be limited to an opportunity to submit information and argument in opposition to the suspension.[77]

If the entity derives all or most of its revenues from doing business with the government, a trial of the criminal False Claims or False Statements Acts charges is generally not a viable option. By the time the trial rolls around, the indicted and suspended entity no longer will be in business or have the wherewithal to defend. Thus, any defenses to the allegations must be presented to the DOJ during the investigation phase in hopes of persuading the government not to indict (and suspend).

If, despite such efforts, it becomes clear that an indictment is inevitable, the entity's guilt or innocence of the criminal charges unfortunately becomes less relevant. The entity's focus typically then shifts to negotiating a global settlement of all of the entity's alleged criminal, civil, and debarment exposure on terms that permit its continued existence. Often, such terms include a guilty plea to some criminal charge.

The manner in which the business responds to a criminal False Claims or False Statement Acts investigation also is very important because of the factors the DOJ considers in deciding whether to prosecute an entity and because of possible debarment issues that may arise. One factor both the DOJ and the debarring official will consider is whether the business organization has cooperated fully with the government during the

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[75] FAR 9.407.2(a)(1), (3).
[76] FAR 9.407-2(b).
[77] FAR 9.407-3(b)(a).

investigation.[78] Thus, the entity has a two-fold incentive to cooperate: to persuade the DOJ to decline criminal prosecution, and—even if that effort is unsuccessful—to persuade the debarring official that despite its past misdeeds, the organization currently is a responsible government contractor. Indeed, the existence of a cause for debarment does not necessarily require that the entity be debarred.[79] The debarring official will consider a number of factors before deciding whether any debarment is in the government's interest and, if so, the length of any such debarment. Two key issues are: whether the entity has fully investigated the circumstances surrounding the cause for debarment and made the results of its internal investigation available to the debarring official; and whether the entity has eliminated the circumstances within its organization that led to the cause for debarment.[80]

It is the interplay between indictment and suspension, and subsequent possible debarment, that makes responding to a criminal False Claims Act/False Statements Act investigation unique and difficult for the defendant and its counsel.

C. Attempts to Enjoin the Government From Suspending an Entity Under Criminal Investigation Generally Prove Futile

Even prior to indictment, an entity may be suspended from being awarded any new contracts or subcontracts upon adequate evidence of violating the criminal False Claims Act or False Statements Act.[81] Regulations define adequate evidence as information sufficient to form the reasonable belief that a particular act or omission has occurred.[82] If the entity's submission in opposition to a suspension raises a genuine dispute over facts material to the suspension, agencies will afford the business an

[78] Thompson Memorandum, *supra* note 56, at 3, 5–6; FAR 9.406-1(a)(3).
[79] FAR 9.406-1(a).
[80] FAR 9.406-1(a)(4) and (9).
[81] FAR 9.407-2(a)(1) and (3).
[82] FAR 2.101.

opportunity to appear with counsel, submit documentary evidence, present witnesses, and confront any person the agency presents.[83] No fact-finding or trial-type hearing will be held, however, if the DOJ attorney conducting the criminal investigation objects that the contemplated legal proceedings based upon the same facts as the suspension would be prejudiced by disclosure of the government's evidence at such a hearing.[84] A failure to provide a full blown, trial-type hearing at which the suspended contractor could confront its accusers and cross-examine witnesses has been held not to constitute a denial of due process.[85]

A suspension that is not based on an indictment shall be terminated twelve months after the date of the suspension notice if no legal proceedings have been initiated, unless an Assistant Attorney General requests an extension, which cannot exceed six months. If legal proceedings have not been initiated within eighteen months of the date of suspension, the suspension must be terminated.[86]

Notwithstanding the entity's suspension, agencies may continue contracts or subcontracts already in existence at the time of suspension.[87] If the agency decides that a contract should not be continued, the decision as to the type of termination to be taken is to be made only after review by agency contracting and technical personnel and agency counsel. Agencies may not renew current contracts or subcontracts of suspended contractors unless the agency head determines that compelling reasons for renewal exist.[88]

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[83] FAR 9.407-3(b)(2).
[84] FAR 9.407-3(b)(6).
[85] ATL, Inc. v. United States, 736 F.2d 677, 686 (Fed. Cir. 1984).
[86] FAR 9.407-4(b).
[87] FAR 9.405-1(a).
[88] FAR 9.405.1(b).

The case of *ATL, Inc. v. United States*[89] demonstrates the difficulties an entity encounters in fighting suspension, while simultaneously responding to a criminal False Statements Act investigation.

In early 1983, ATL, a Hawaiian construction company and small business concern, was the low bidder on four separate U.S. Navy contracts. Unbeknownst to ATL at the time, the company also was the subject of a Naval Investigating Service criminal investigation relating to its performance of ongoing and prior contracts. After the Navy dragged its feet in awarding the four contracts, ATL filed suit in the Claims Court on July 6, 1983, requesting a cut-off date of the Navy's responsibility review and, if necessary, referral to the Small Business Administration. On July 12, 1983, the Claims Court denied ATL's claim for injunctive relief, but set a trial date for July 18, at which time ATL was to prove that the Navy's delays in awarding the four contracts constituted *de facto* suspension or debarment.

On July 15, 1983, the Navy obliged by suspending ATL from further contracting with any federal government agency, listing nine items reflecting an alleged lack of integrity. The July 15 suspension letter informed ATL that no fact-finding proceeding would be conducted because of a request from the United States Attorney's Office in Honolulu, but that ATL could present information in opposition to the suspension in person or in writing. On September 7, 1983, ATL did make a presentation before the Navy Debarment Committee that included testimony from company employees. Almost three months after the September 7 proceeding, the Navy informed ATL that the suspension would continue based on two of the original nine charges.

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[89] 736 F.2d 677 (Fed. Cir. 1984).

Meanwhile, ATL continued to fight in the Claims Court to prevent the Navy from awarding the four contracts on which it was low bidder to other contractors. On January 6, 1984, the Claims Court issued a decision continuing to enjoin the Navy from awarding the four contracts to anyone else until after a suspension decision based upon a "new and proper hearing." In its January 6, 1984 decision, the Claims Court found the Navy Debarment Committee's suspension proceeding deficient in a number of respects, including insufficient specificity in the notice of suspension; the Navy's refusal to grant ATL access to certain documentary materials prior to the September 7 proceeding; the failure to provide ATL with an opportunity to confront and cross-examine accusers; and failure to provide a neutral tribunal.

On appeal, the Federal Circuit reversed, in a May 25, 1984 decision, on all but one ground, namely, the failure to grant ATL access to certain documentary materials prior to the September 7, 1983 proceeding.[90] The Federal Circuit continued to enjoin the Navy from awarding the four contracts to anyone else until ATL had been granted access to the documentary materials at issue and until new hearing or proceeding had been conducted after such access had been granted.

On September 5, 1984, ATL and its principal officers were charged in a 79 count indictment with False Statements Act violations in connection with the performance of prior government contracts. However, the indictment did not include the contracts or charges that formed the basis for ATL's suspension more than a year earlier.

On October 14, 1984, ATL filed a summary judgment motion in the Claims Court asking that the Court enter an order declaring the July 15, 1983 suspension unlawful and

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[90] 736 F.2d at 684–86.

void, and stating that ATL was entitled to the award of the four Navy contracts on which it was the low bidder.

On November 2, 1984, the Navy issued a new suspension notice based upon the September 5, 1984 indictment of ATL and its principal officers.

Twelve days later, the Claims Court denied ATL's motion for summary judgment, thus, permitting the Navy to award the four contracts at issue to other contractors. Although troubled by the due process issues raised by the Navy's conduct, neither the Claims Court nor the Federal Circuit were prepared to order the immediate award of the four contracts to ATL while the company remained under the cloud of a criminal investigation.

In retrospect, ATL's interests may have been better served by spending its resources on resolving the criminal allegations, any civil claims, and any debarment exposure in a manner that might have permitted the company to resume doing business with the federal government at some point in the not too distant future.

D. Initial Steps and Prevention of Post-Investigation Obstruction of Justice

Criminal investigations can begin in any one of a number of ways, including an audit, a response to a claim for an equitable adjustment, a complaint from a competitor, or increasingly, a *qui tam* action filed by a disgruntled former or current employee.

The government typically has a substantial head start before the entity first learns it is under investigation. Often the entity's initial notice comes from a former employee who is contacted by the FBI or an Office of Inspector General ("OIG") agent seeking an interview. The FBI and OIG agents are free to interview former employees and also are free to attempt to interview current employees prior to receiving notice that the entity is represented by counsel in the investigation. The entity also may learn of the investigation

as a result of being served with a grand jury or OIG subpoena for the production of documents or as a result of the execution of a search warrant on its premises.

Once an company that does business with the federal government is served with a subpoena or otherwise learns that it may be under investigation, it should immediately retain a law firm that has both criminal and government contracts expertise and prior experience in representing entities responding to such investigations. Counsel's immediate objective is to prevent the entity and its employees from compounding whatever problems exist through panic, ignorance, arrogance, or recklessness. The entity should issue a memorandum to its employees informing them of the existence of a federal government investigation, its understanding of the nature of the investigation, and directing the employees to preserve all documentary materials and electronically stored information that may be relevant to the investigation. The memorandum also should state that the entity has hired law firm "X" to represent the company in the investigation; that all employees should cooperate fully with law firm "X"; that a failure to do so will result in disciplinary action, including possible termination; and that employees should not discuss the matters under investigation with anyone other than counsel, not talk about such matters among themselves and not create documents or e-mails relating to such matters.

Some companies resist issuing this kind of memorandum for fear that it will publicize the company's criminal investigation to employees, competitors, and customers, and, thereby, damage the company's prospects of obtaining additional business. Organizations that fail to take such action, however, later may find themselves accused of obstruction of justice because of the inadvertent destruction or discarding of documents or deletion of e-mails.

Once retained, counsel typically will write the investigating agency or DOJ and state that the firm represents the entity in the investigation. Such a letter should prevent the government from interviewing current employees without prior notice to counsel. This notification will give the entity and its counsel some breathing space to begin to respond to the investigation and hopefully to prevent employees from consenting to be interviewed without understanding their rights fully in that situation or the consequences of failing to provide truthful and complete answers.

Martha Stewart was not convicted of criminal violations of the securities laws. Instead, she was convicted of conspiring to obstruct justice and of making false oral statements to the FBI and other federal officials conducting an investigation of possible securities laws violations. Absent education and training, few individuals know, for example, that lying to a federal agent is a violation of the False Statements Act, a felony punishable by up to five years imprisonment and a $250,000 fine.

Counsel also will initiate a dialogue with the government to ascertain the possible violations being investigated and the entity's status in the investigation: Is it a target or subject of the investigation? Or, is it merely a third-party witness providing information relevant to others under investigation? Absent assurances from the government that the investigation is of someone else, the entity and its counsel should assume it is a subject of the investigation.

E. Avoiding Prosecution Despite Criminal Liability: Internal Investigations and the McNulty Memorandum

The entity must conduct its own internal investigation to unearth the truth relating to the subject matter of the government's investigation. It must conduct an expeditious and thorough inquiry to ascertain the facts and determine how the entity should respond. If the internal investigation determines that one or more employees have violated the

criminal False Claims Act or False Statements Act, the entity likely will decide to terminate or sanction the culpable employees, disclose the results of the investigation to the DOJ, determine the amount of any loss to the government, and rectify the situation.

Under the McNulty Memorandum, the DOJ will consider the following factors in deciding whether to prosecute the entity criminally:

1. The nature and seriousness of the offense, including the risk of harm to the public;

2. The pervasiveness of wrongdoing within the organization, including the complicity in, and/or condoning of, the wrongdoing by corporate management;

3. The company's history of similar conduct, including prior criminal, civil and regulatory enforcement actions against the company;

4. The company's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of the company's employees;

5. The existence and adequacy of the company's pre-existing compliance program;

6. The company's remedial actions, including efforts to implement an effective compliance program, or improve an existing one, replace responsible management, discipline or terminate wrongdoers, pay restitution and cooperate with the relevant government agencies;

7. Collateral consequences, including disproportionate harm to shareholders, pensioners and employees not proven personally culpable and impact on the public arising from the prosecution;

8. The adequacy of prosecution of individual wrongdoers; and

9. The adequacy of civil and regulatory enforcement actions.[91]

The premise of both the McNulty Memorandum and the factors considered by the debarring official, pursuant to FAR 9.406-1, is that the entity in fact has committed a criminal False Claims Act violation, False Statements Act violation, or other criminal

[91] Thompson Memorandum, *supra* note 56, at 3.

offense. The best of all possible scenarios, of course, is that the entity's internal inquiry will establish that no such violation has occurred. In other words, in responding to a criminal False Claims/False Statements Acts investigation, the entity and its counsel can pursue two lines of defense: we didn't do it; and even if we did, the overall public interest would not be served by prosecuting us because we have terminated the really culpable individuals, implemented other effective remedial efforts, cooperated fully, and made restitution.

An expeditious and thorough internal investigation is crucial to preserve the entity's ability to pursue the second line of defense successfully prior to indictment and avoid all of the adverse consequences—direct and collateral—that flow from indictment, prosecution, and possible conviction. Generally, the entity will want an investigative team that includes outside counsel to conduct the internal investigation so that the results will likely be protected by the attorney-corporate client privilege, at least initially. The investigative team also should include someone from the entity who was not involved in the conduct under investigation and who knows the business. This individual presumably will know where the relevant documents and information resides, which current and former employees should be interviewed, and what the entity's normal operating procedures are. The objective of the internal investigation is to attempt to ascertain quickly the true facts and to determine whether the government is mistaken and no violation took place, or whether a violation did occur. In the latter situation, the company must stop any unlawful activity, decide whether to terminate or otherwise discipline the employees involved, take steps to prevent a recurrence, determine the extent of any loss to the government, offer to make restitution, and disclose the results of its internal

investigation to the government in hopes of persuading the government to decline criminal prosecution and/or forebear from imposing a significant term of debarment.

Many of the McNulty Memorandum factors are similar to those that the debarment official will consider in deciding whether to debar the entity and, if so, for how long. They are:

1. The nature and seriousness of the offense,
2. The pervasiveness of wrongdoing within the organization,
3. The entity's timely and voluntary disclosure and its willingness to cooperate in the investigation,
4. The adequacy of its compliance program and the remedial actions taken, including restitution and the disciplinary action taken against wrongdoers.

If the investigative team determines that a criminal False Claims Act or False Statements Act violation occurred, the company and its counsel should consider voluntarily disclosing the following to the debarment official: the entity is the subject of a criminal False Claims or False Statements Act investigation; it is cooperating fully with the DOJ's investigation; its internal investigation indicates a violation did occur; it is willing to make full restitution and take whatever remedial actions are necessary to prevent a recurrence; and it will provide a more detailed report when the DOJ investigation and its internal investigation have been concluded.

A timely, voluntary disclosure to the debarment official should be viewed by the DOJ prosecutors as an indication that the entity has accepted responsibility for the violation that occurred and is willing to deal forthrightly with the relevant government agency, i.e., the debarment official, in taking the necessary remedial actions. In sum, such action should be considered as a factor favoring the declination of any criminal prosecution and debarment or minimize the term of any debarment.

At or about the time that the DOJ's criminal investigation is resolved, the entity should consider making a more complete report to the debarment official setting forth the reasons why—regardless of what happened in the past—it is now a responsible government contractor.

For the same reasons, an entity's chances of avoiding criminal prosecution likely are enhanced if it can tentatively resolve its alleged civil FCA liability. While the entity may have pledged to make restitution, i.e., single damages, to the government, the DOJ's Civil Division Commercial Litigation Branch attorneys may assert that it acted "knowingly" within the meaning of the civil FCA and, thus, is liable for treble damages and civil penalties. This means, of course, that the entity must deal with a second set of DOJ attorneys different from those conducting the criminal investigation. Once again, the fact that the entity has faced up to, and one hopes, tentatively resolved, any alleged liability, should be viewed by the DOJ prosecutors as an acceptance of responsibility and a factor in favor of declination.

F. Maintaining the Company's Credibility Is Crucial to Achieving a Successful Resolution of a Criminal False Claims/ False Statements Act Investigation

1. Full and Complete Compliance with a Subpoena for Documents and Information

Many companies destroy their credibility and never recover by failing to conduct an adequate search for documents and electronically stored information ("ESI") in response to a grand jury or OIG subpoena. Once a company's credibility is lost, it is generally gone forever for the purpose of being deemed "cooperative."

Typically, the company and its counsel will negotiate with the DOJ attorneys to narrow the scope of the subpoena and ease the burden of searching for and producing, responsive documents and ESI. It is essential that the company comply fully with the

subpoena as modified as a result of these negotiations. The McNulty Memorandum cites "incomplete or delayed production of records" as an example of conduct intended to impede an investigation and a factor to be weighed against the company in making a charging decision.[92] The search for responsive documents and ESI should unearth all responsive materials—good and bad. If the investigation began as the result of a *qui tam* action (something the entity is not likely to know at the time of subpoena compliance), it is important to remember that the whistleblower likely already has provided the government with the worst of the company's documents. It is difficult for a "cooperating" corporation to maintain its credibility with the government where the corporation's "full and complete" document production fails to include a "bad" document that the government already has in its possession from the whistleblower.

Counsel needs to be familiar with all of the "bad" documents and e-mails so that they may be addressed and put in context. If unaware of their existence, counsel may make oral representations to the government that clearly are wrong and at odds with the documents' contents. In such a situation, the DOJ may decide that counsel is dissembling and cannot be trusted or that the company is lying to its lawyer.

Companies often like to skimp on the cost of searching for and producing documents and ESI responsive to the subpoena. Rather than involve the lawyers in this phase, companies often will do the search themselves, do it poorly, and suffer the consequences later. The better approach is to have the investigative team interview the relevant employees and identify and collect responsive documents and ESI from them at the time of the interview. As part of this process, the company may want to have the employee certify that he or she has read the subpoena, that they understand what is called

[92] McNulty Memorandum, *supra* note 57, at 12.

for, and that they have provided the investigative team with copies of all of the responsive materials in their possession and custody or under their control. While this process is more expensive, it is the kind of search that buys the company credibility with the government.

2. Representation of Current and Former Employees

After the government has reviewed the company's response to the subpoena, it typically wishes to interview certain current and former employees. As mentioned earlier, once the company is represented by counsel, the government must notify the company's lawyers before attempting to interview current employees. The government is free, however, to interview former employees without providing any notice to the company's lawyers.

Assume the government contacts counsel for the company and requests interviews with current employees A, B, and C. Employees A and B say they would like to talk to a lawyer before deciding whether to consent to an interview. Employee C, on the other hand, says he is willing to be interviewed and doesn't feel he needs a lawyer.

The questions of who represents the employees and whether the company advances their legal fees should be thought through carefully and generally answered only after some initial internal investigation and after counsel for the company have established a working relationship or dialogue with the DOJ attorneys conducting the criminal investigation. First, the company does not wish to advance legal fees for the representation of clearly culpable employees unless it is required to do so by its corporate charter, bylaws or because of the individual's employment contract. Employees who have been terminated as the result of the company's internal investigation likely fall into this category of clearly culpable employees. According to the McNulty Memorandum,

shielding culpable employees and agents is a factor to be weighed against the company in making a charging decision.[93]

Assume further that employees A, B, and C are mid-level employees and that the DOJ attorneys have confirmed that they are not perceived as "culpable" employees. Usually, the government interviews lower and mid-level employees to elicit information adverse to the company and upper management Under these circumstances, it is generally problematic if the lawyer representing the company also attempts to represent employees A, B, and C for purposes of their interviews. First, the lawyer would be required to explain the advantages and risks involved in such joint representation and obtain a waiver of any actual or potential conflicts of interest from both the employees and the company. Second, the McNulty Memorandum expressly mentions "overly broad assertions of corporate representation of employees or former employees" as an example of conduct intended to impede an investigation and a factor to be considered against the company in making a charging decision.[94] The government typically will suspect that company counsel's true, primary loyalty is to the company, not to the employees, and that employees A, B, and C will not be candid and forthright at their interviews if counsel for the company is present—fearing they will lose their jobs if they say something adverse to their employer. Third, if employee A, B, or C is a subject of the investigation, his or her personal interest may be best served by refusing to consent to an interview unless and until granted some form of use immunity pursuant to 18 U.S.C. § 6001, *et seq.*, or by agreement with the DOJ. It is difficult for a lawyer credibly to assert that his or her corporate client is "cooperating" with the investigation, while simultaneously demanding that his or her employee clients receive use immunity prior to consenting to

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[93] McNulty Memorandum, *supra* note 57, at 11.
[94] *Id.* at 12.

be interviewed. If employees A, B, or C wish to avail themselves of the protection the use immunity provides, it is usually better if the employee is represented by separate counsel.

If the company and employees A, B, and C all have separate counsel, the company can truthfully represent that it is encouraging all of its employees to cooperate, but that the ultimate decision rests with the employee and his or her lawyer.

Thus, the better practice is to have separate legal representation for the employees—perhaps one lawyer for all of the employees until conflicts develop among them. Separate representation enhances the company's chances of maintaining its all-important credibility with the government.

Who pays for the lawyer for the employees? Ordinarily, advancing legal fees is a matter within the company's discretion. Thus, the company can tell employees A and B that they are free to talk to a lawyer but that they will have to pay for it themselves. On the other hand, if the government seeks to interview A, B, and C because of their employment in the company about matters that occurred during their employment, it is perhaps only fair that the company bear the cost of their legal representation.

Counsel for the entity typically prefer that the company pay for the employees' separate legal representation for additional reasons. If the company is paying, it is in a better position to recommend counsel who are experienced in handling these kinds of matters, as opposed to having the employee fend for himself in finding a lawyer. While counsel for the employees are bound by their clients' instructions, there is also the hope that the employees will authorize their counsel to disclose what transpired during the interviews to counsel for the company.

Now, let's assume former employee D calls the company and indicates he's been contacted by the FBI about being interviewed. Former employee D says he would like to talk to a lawyer and asks whether the company will pay his legal fees.

Many companies pay for the legal representation of former employees, as well as that of current employees. Some, however, draw the line at current employees.

Needless to say, responding to a criminal investigation can become burdensome and expensive, especially for a small- or medium-sized government contractor.

G. The McNulty Memorandum, Government Requests for Waivers of Privileged Communications and Advancing Legal Fees to Employees

Assume that in the course of collecting materials responsive to the grand jury or OIG subpoena, counsel for the company has interviewed employees A, B, and C about the matters being investigated before the company provided these employees with a lawyer. Counsel for the company has prepared memoranda memorializing what was said in those interviews. When the company discloses the results of the investigative team's internal investigation to the government, it must decide whether it wishes to waive the attorney-client and work product privileges covering those materials and produce the privileged materials as well.

Under the Thompson Memorandum, there was a perception in the business community and among defense counsel that waiver of the company's attorney-client and work product privileges was a *de facto* prerequisite to being viewed as a "cooperating" corporation. The Thompson Memorandum also was construed as suggesting that a corporation should not advance the payment of legal fees to its employees if it wished to be viewed by DOJ as "cooperating."

The relevant portions of the Thompson Memorandum provided:

> One factor the prosecutor may weigh in assessing the adequacy of a corporation's cooperation is the completeness of its disclosure including, if necessary, a waiver of the attorney-client and work product privileges, ...
>
> * * *
>
> Another factor to be weighed by the prosecutor is whether the corporation appears to be protecting culpable employees and agents. Thus, while cases will differ depending on the circumstances, a corporation's promise of support to culpable employees and agents, either through the advancing of attorneys fees, through retaining employees without sanction for their misconduct, . . . , may be construed by the prosecutor in weighing the extent and value of a corporation's cooperation.[95]

Both of these facets of the Thompson Memorandum became the subject of considerable criticism. In June 2006, U.S. District Court Judge Lewis A. Kaplan held that the government's implementation of the Thompson Memorandum in *United States v. Stein*[96] violated certain KPMG employees' Fifth and Sixth Amendment constitutional rights to due process and the effective assistance of counsel by causing KPMG to cut off the payment of legal fees upon indictment. On December 8, 2006, Senator Arlen Spector, then the Chairperson of the U.S. Senate Judiciary Committee, introduced S. 30, the Attorney-Client Privilege Protection Act of 2006. This proposed legislation would prohibit a DOJ attorney from using a refusal to waive a valid attorney-client or work product privilege or the advancement of legal fees to employees as factors in a charging decision.

The McNulty Memorandum was issued to address Judge Kaplan's criticism of the DOJ's alleged overreaching tactics under the Thompson Memorandum and diffuse some of the impetus for enactment of Senator Spector's Attorney-Client Privilege Protection Act of 2006.

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[95] Thompson Memorandum, *supra* note 56, at 5.
[96] United States v. Stein, 435 F. Supp. 2d. 330, (S.D.N.Y. 2006).

The McNulty Memorandum directs federal prosecutors to consider basically the same factors set forth in the Thompson Memorandum in deciding whether to indict a corporation or other business entity. Moreover, it does not preclude DOJ attorneys from requesting a waiver of the attorney-client and work product privileges or voluntary corporate waivers of such privileges.

The McNulty Memorandum states:

> Waiver of attorney-client and work product protections is not a prerequisite to a finding that a company has cooperated in the government's investigation. However, a company's disclosure of privileged information may permit the government to expedite its investigation. In addition, the disclosure of privileged information may be critical in enabling the government to evaluate the accuracy and completeness of the company's voluntary disclosure.
>
> Prosecutors may only request waiver of attorney-client or work product protections when there is a legitimate need for the privileged information to fulfill their law enforcement obligations. A legitimate need for the information is not established by concluding it is merely desirable or convenient to obtain privileged information. The test requires a careful balancing of important policy considerations underlying the attorney-client privilege and work product doctrine and the law enforcement needs of the government's investigation.[97]

If a legitimate need exists, prosecutors are directed first to seek a waiver for purely factual, so-called "Category I", information, such as witnesses statements. Before requesting a waiver of privileged Category I information, prosecutors must obtain written authorization from the United States Attorney, who must, in turn, consult with the Assistant Attorney General for the DOJ's Criminal Division before granting or denying the request.

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[97] McNulty Memorandum, *supra* note 57, at 8–9.

The McNulty memorandum also provides that "[p]rosecutors generally should not take into account whether a corporation in advancing attorneys' fees to employees or agents under investigation or indictment."[98]

It remains to be seen how DOJ prosecutors in the field will construe and apply the somewhat softened reiteration of these factors in the McNulty Memorandum.

V. Resolution of Threatened Criminal False Claims Act/ False Statements Act Charges

A. Deferred Prosecution Agreements

Upon the return of the indictment in *United States v. Arthur Andersen*, the accounting firm was suspended from receiving any new contracts from the federal government. Because most of Arthur Andersen's work was private, it was able to proceed to trial, albeit the case was ultimately unsuccessful.

As mentioned earlier, however, a criminal trial generally is not a viable option for a company that derives all or most of its revenues from doing business with the federal government. During the year or more between indictment and trial, such an entity is likely to go out of business or no longer have the resources to defend.

Until relatively recently, the prosecutor's options for resolving possible criminal charges against a corporation were binary: indict and prosecute the corporation; or decline criminal prosecution altogether. Spurred, in part, by the consequences of the criminal prosecution and conviction in *Arthur Andersen*, namely, the demise of the nation's fifth largest accounting firm, prosecutors have turned increasingly to deferred prosecution agreements ("DPA's") (also referred to as "pretrial diversion") or non-prosecution agreements ("NPA's"), as a middle ground for resolving allegations of corporate guilt. DPAs and NPAs permit the prosecutor, in effect, to impose a

[98] McNulty Memorandum, *supra* note 57, at 11.

probationary sentence that extracts an appropriate pound of flesh, but permits the entity to survive without a criminal conviction on its record, if it lives up to the terms of its agreement.

In a DPA, a criminal complaint is filed or an indictment returned, but the case is not prosecuted and ultimately the charges are dismissed, unless the corporate defendant violates the terms of its agreement. The NPA is similar except that no charge is actually filed unless the entity breaches the agreement.

DPAs and NPAs are written contracts between the DOJ and the corporation in which the entity typically admits that it engaged in criminal conduct as set forth in a detailed statement of facts. If the entity breaches the DPA or NPA, the detailed statement of facts can be introduced into evidence against it as an admission against interest in a subsequent criminal prosecution.

DPAs and NPAs are ordinarily for a term of two to three years. Such agreements typically include payment of restitution or a fine or both, cooperation with the government's ongoing investigation of culpable individuals, implementation of compliance, governance as other remedial measures and appointment of an independent monitor (at company expense) to ensure compliance with the terms of the agreement.

DPAs and NPAs include most of the provisions that would be imposed if sentenced under the U.S. Sentencing Commission's ("USSC") Sentencing Guidelines For Organizations after being convicted, namely, restitution, fine, remedial order, and probation. The advantage, of course, is that the company avoids the stigma of a criminal conviction and some of its collateral consequences.

Thus far, DPAs and NPAs appear to have been used mainly in matters involving large, publicly held corporations, where a conviction would cause significant injury to

innocent shareholders and employees. Nonetheless, the McNulty Memorandum recognizes that DPAs and NPAs may be appropriate for all entities in certain circumstances.

The DOJ prosecutors have the discretion to decline criminal prosecution altogether without an NPA or a DPA, or to resolve the matter with an NPA or a DPA, or to indict and prosecute. The DOJ has not chosen to provide guidance on why one matter might be resolved with an NPA as opposed to a DPA. The entity and its counsel will presumably shoot for an outright declination, fall back to an NPA if the prosecutor is not willing to decline prosecution, and, then, if unable to get an NPA, seek a DPA.

B. Criminal Prosecution

The legal standard for corporate criminal liability in the federal court system is a relatively easy one for a prosecutor to meet. As mentioned earlier, a corporation may be convicted for the acts of its employees where the employee is acting within the scope of his/her employment and for the ostensible benefit of the corporation.

An agent's conduct which is actually or potentially detrimental to the corporation may nonetheless be imputed to the corporation in a criminal case if motivated at least in part by an intent to benefit the corporation.[99]

To prove a violation of the criminal False Statements Act, the prosecution must prove that a defendant acted "willfully," i.e., intentionally and with bad purpose to disobey or disregard the law. The knowledge possessed by a corporation's employees,

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[99] United States v. Sun-Diamond Growers of Cal., 138 F.3d 961, 1970-71 (D.C. Cir. 1988) (affirmed corporation's wire fraud and illegal campaign contribution convictions on grounds that jury was entitled to conclude that employee was acting with an intent "however befuddled" to further the interests of his employer); United States v. Cincotta, 689 F.2d 238, 241–242 (1st Cir.), *cert. denied*, 74 L.Ed 2d 387 (1982) (holding that acting within the scope of employment meant the agent must be "performing acts of a kind he is authorized to perform" and those acts must be motivated—at least in part—by an intent to benefit the corporation).

however, may be aggregated[100] so that a corporate defendant is considered to have acquired the collective knowledge of its employees to determine if it acted "willfully".[101]

The corporation can be held criminally liable even if its agents are acquitted of the same offense.[102]

The corporation can be held criminally responsible even when its employee violates corporate policy and was specifically directed not to perform the illegal act.[103]

C. U.S. Sentencing Commission Guidelines for Organizations

In January 2005, the U.S. Supreme Court decided *United States v. Booker*,[104] which made the USSC's Sentencing Guidelines "advisory" instead of mandatory. Nonetheless, Booker instructs judges to give the Sentencing Guidelines significant consideration and many courts continue to apply them. For these reasons, before a company proceeds to trial, the entity and its counsel should weigh the consequences of an adverse result under the Sentencing Guidelines for Organizations (the "Guidelines").

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[100] Although knowledge possessed by corporation is aggregated so that a corporate defendant is considered to have acquired the collective knowledge of its employees, specific intent cannot be so aggregated. United States v. LBS Bank-New York, Inc., 757 F. Supp. 496, 501 n. 7 (E.D. Pa. 1990) (bank convicted by jury of conspiracy to defraud the United States by filing false and fraudulent CTRs and/or failing to file Reports of Apparent Crimes).

[101] United States v. Bank of New England, N.A., 821 F.2d 844, 854–56 (1st Cir. 1996) (upheld collective knowledge and conscious avoidance instructions in affirming conviction of bank for failing to file currency transaction reports in violation of Bank Secrecy Act); United States v. T.I.M.E.-DC, Inc., 381 F. Supp. 730, 738–39 (W.D. Va. 1974) (in prosecution of trucking company for willful and knowing violation of Federal Highway Administration regulations, held corporation could not plead innocence by asserting that information obtained by several employees was not acquired by any one individual employee who would have comprehended its full import).

[102] United States v. Hughes Aircraft Co., 20 F.3d 974–978 (9th Cir. 1994) (affirmed conviction of corporation for conspiring to submit false statements despite jury acquittal of co-defendant employee); United States v. LBS Bank-New York, Inc., 757 F. Supp. 496, 501–03 (E.D. Pa. 1990) (held that jury could consider the bank Chairman's conduct for purposes of convicting the corporation, while acquitting him).

[103] U.S. v. Automated Medical Labs, Inc., 770 F.2d 399, 406-407 (4th Cir. 1985) (upheld conviction of laboratory for falsification of logbooks and conspiring to defraud FDA despite fact that employees' conduct violated corporate policy); U.S. v. Basic Construction, 711 F.2d 570, 573 (4th Cir.), *cert. denied*, 78 L.Ed.2d 330 (1983) (affirmed bid rigging conviction of corporation despite the fact that conduct was perpetrated by two minor officials, was done without the knowledge of high level corporate officers and was in violation of longstanding, well-known and strictly enforced corporate policy).

[104] 543 U.S. 220 (2005).

The USSC's Guidelines envision a three-part sentence. First, the court must, wherever practicable, order the entity to remedy the harm caused by the offense including payment of restitution to identifiable victims, in this case the government. According to the introductory comments to the Guidelines, the resources expended to remedy the harm should not be viewed as punishment, but as a means for making the victims whole for the harm caused. Second, the court must determine a fine based on the seriousness of the offense and the entity's culpability. Third, the court may place the company on probation to ensure that remedial action will be taken, that the fine will be paid, or that further violations will be prevented.

The determination of the fine involves a complex series of calculations. The court initially determines a base fine according to the seriousness of the offense. The base fine is the greatest of the pecuniary gain to the company, the pecuniary loss caused by the offense, or the amount in a guideline offense level table. Under the Guidelines, every offense is assigned a numerical base offense level ("BOL"). For a criminal False Claims Act/False Statement Act violation, a company starts with a BOL of 6, which will be increased or reduced by the presence or absence of certain aggravating or mitigating factors. If the court were to determine that the offense caused the government to lose $1.5 million, the BOL would be increased to 22. At a BOL of 22, the base fine would be $1.5 million because the loss exceeds the $1.2 million fine from the guideline offense table in section 8C2.3 of the Guidelines.

Next, the court calculates the entity's culpability score, which, in turn, determines the minimum and maximum multipliers applied to the base fine. The convicted entity begins with a culpability score of 5, which also goes up or down according to the presence or absence of certain aggravating or mitigating factors. The sentencing court

will consider six factors in determining the defendant's culpability score, which mirror or at least resemble the factors in the McNulty Memorandum and FAR 9.406-1. The four factors that will increase the culpability score are: the entity's involvement in or tolerance of criminal activity; the prior history of similar misconduct; the violation of a judicial order, injunction or condition of probation; and obstruction of justice.

The two factors that may mitigate the entity's culpability score are: the existence of an effective compliance and ethics program ("ECEP"); and self-reporting, cooperation, or acceptance of responsibility.

Assume that the convicted company has more than 50, but less than 200 employees. Assume further that the plant manager participated in the offense and that the entity failed to take reasonable steps to prevent the destruction of relevant documents after being served with a grand jury subpoena, i.e., obstruction—for purposes of the Guidelines. The convicted company's culpability score would be increased by 2 points because of the involvement of the plant manager and increased by 3 points because of the obstruction for a total culpability score of 10. At a culpability score of 10, the recommended fine would be between a minimum of $3 million and a maximum of $6 million.

If the convicted company had an effective compliance ECEP in place at the time of the offense, the culpability score would be reduced from 10 to 7 points. If the entity cooperated fully with the investigation and affirmatively accepted responsibility for its criminal conduct, the culpability score would be reduced from 7 points to 5 points. At a culpability score of 5, the multipliers applied to the base fine would be lower and, thus, the recommended fine would be between $1.5 million and $3 million.

In sum, the convicted company would make restitution in the amount of $1.5 million and likely pay an additional fine within a range determined by its culpability score. If the company did not have an ECEP in place at the time of the offense, either the sentencing court, the DOJ attorneys handling the civil False Claims action, or the debarment official (or all three) would very likely impose one as a condition of probation, as a condition of settling the civil False Claims Act action, or pursuant to the resolution of the company's debarment liability.

The Guidelines are relevant principally for two reasons.

First, they are generally thought to strengthen the DOJ prosecutor's hand in extracting a guilty plea to one or two counts and therefore avoid having the company go to trial, risk being convicted of multiple offenses, and be subject to all sorts of allegedly applicable aggravating factors resulting in a horrendous fine. If the DOJ decides to indict and prosecute the company criminally, many defense attorneys would prefer to explore a possible global settlement of all of the entity's criminal, civil, and debarment liability—prior to the entry of a guilty plea in the criminal action.

The Guidelines also are relevant because over the years, there has been a gradual acceptance of the idea that companies should have an ECEP and that such programs should meet the Guidelines' criteria for such programs.

D. Every Federal Contractor Should Have an ECEP That Arguably Meets the Guidelines' Criteria

According to the McNulty Memorandum, the existence of an ECEP, coupled with other factors consistent with federal law enforcement policy, "may result in a decision to charge only the corporation's employees and agents."[105] For this reason alone, every company doing business with the federal government should have one.

[105] McNulty Memorandum, *supra* note 57, at 14.

During the past fifteen years since the USSC's organizational Guidelines first were promulgated, the existence of an ECEP has become the norm in the eyes of federal authorities. A federal contractor's failure to have such a program will stick out like a very sore thumb if the entity ever is the target of a criminal investigation, has exposure, and seeks a declination of criminal prosecution.

According to attorneys, F. Joseph Warin and Michael Billok, only two of the 865 organizations sentenced under the Guidelines over an eight-year period had an ECEP.[106] Indeed, only sixteen of 377 organizations sentenced during 2000–2004 had any compliance program at all.[107]

While the criteria for an ECEP appears daunting, the Guidelines recognize that a small- or medium-sized company need not have a program that is as elaborate as GE's or Northrop Grumman's. Organizations are required to establish standards and procedures to prevent and detect criminal conduct. They are required to communicate those standards and procedures to their employees periodically, either through training programs or through other means; to take reasonable steps to ensure that the program is being followed, including monitoring and auditing to detect criminal conduct; and to take disciplinary action against those who engage in criminal conduct or are negligent in failing to prevent or detect such conduct. After criminal conduct is detected, the organization is required to respond appropriately and prevent further similar criminal conduct.[108]

A small company is expected to demonstrate the same degree of commitment to ethical conduct as a large organization, but the USSC recognizes that a small entity may

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[106] F. Joseph Warin and Michael D. Billok, *Navigating the Legal Requirements Of Internal Compliance Programs*, CORP. GOVERNANCE ADVISOR, Nov. 2004, at 2.

[107] *Id.*

[108] For a more complete discussion of all seven of the Guidelines criteria, see § 8B2.1 and the application notes at http://www.ussc.gov/2005guid/tabconchapt8.htm.

meet the Guidelines' ECEP requirements with a program that is less formal and has fewer resources.

Of the seven factors that DOJ prosecutors are directed to consider under the McNulty Memorandum before indicting an organization, only three are really under the entity's control: the corporation's timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents; its remedial actions; and its pre-existing compliance programs. None of these by itself is sufficient to assure that a criminal prosecution will be declined. It is a combination of these factors that may carry the day in persuading the DOJ to decline criminal prosecution despite the company's technical legal guilt. Viewed in this perspective, it seems clear that every company that does or intends to do substantial business with the federal government should make the necessary investment in an ECEP.