Blowing the Whistle on Fraud

What contract managers choose to do when confronted with fraud greatly affects their future, both professionally and financially.

BY ERIC R. HAVIAN

Robert Neargarder knew there was a problem when he saw internal company documents that showed his company actually had budgeted far less for weapons-oriented independent research and development (R&D) than what it had told the government it intended to spend in the coming years.

Based on the inflated numbers, the government had agreed to reimburse the company for its R&D costs as part of the price of numerous weapons systems the company was building. Neargarder had helped negotiate the R&D reimbursement arrangement with the government, based on information provided by his supervisors. But he learned that the company did not intend to spend on many R&D programs as much as it had projected, and on some it planned to spend nothing at all. Yet the costs of this phantom R&D became part of the price of numerous government defense contracts.

Neargarder's story is one that many contract managers can tell. Fortunately, his has a happy ending due to a federal law known as the False Claims Act. As Neargarder found—and as is the case for many other whistleblowers—the most effective means to stop fraud and protect one's career and financial future is to file a "qui tam" or "whistleblower" lawsuit under the False Claims Act.

Frustration and Fear of Prosecution

When Neargarder found out about the fraud, he complained to senior company officials. But that had virtually no effect; the company even inflated its R&D costs in contract negotiations the following year.

A 10-page letter to the U.S. Department of Defense (DOD) fraud hotline prompted an initial promising response. Neargarder met with federal agents who appeared genuinely interested in his allegations. But after two years, there had been little progress. Despite the fact that tens of millions of dollars were at stake, the agents complained that the government lawyers had put the matter on a back burner.

In addition to the lack of progress in calling the company to account, Neargarder was also concerned about his own exposure. After all, he had been the one to provide the government, even if unwittingly, with the falsely inflated numbers. Without a law background, Neargarder wondered whether the government's investigation might take a wrong turn and target him as the culprit, even though he had been the one to blow the whistle.

In response to Neargarder's concern and frustration, one of the agents quietly gave him my name and the name of another attorney. Both of us had recently left the U.S. Department of Justice (DOJ) and now represented whistleblowers under the False Claims Act, a Civil War-era fraud law that allows whistleblowers to sue companies defrauding the federal government and to receive a share of whatever funds the government recovers as a result of the lawsuit.

It seemed like a win-win decision by the agent. Neargarder might get some helpful legal advice about resolving his discomfort with the company's misconduct. The agent, who believed Neargarder had uncovered real fraud, also hoped the filing of a whistleblower lawsuit might force government attorneys to pursue the matter seriously.

Neargarder called us and we quickly filed a "qui tam" lawsuit under the False Claims Act. Eighteen months later, Neargarder's company paid the federal government $13 million to settle the case. Neargarder received a share of that settlement—$3 million—as his reward for filing the qui tam lawsuit and providing the government with evidence of the fraud.

He also got some unexpected benefits. As part of the settlement, the company gave Neargarder a very attractive early retirement package, including a full vesting of benefits and full pay for the time period he was on leave while the case was pending.

Neargarder's experience with fraud is not an uncommon one. The potential for fraud is great in the negotiations and billing for government contracts. What contract managers choose to do when confronted with fraud, however, greatly affects both their professional and financial future.

Types of Fraud

The type of fraud Neargarder encountered remains one of the most common that contract managers might see in government contract negotiations. Inflating costs during negotiations with the government to get a higher price for a sole-source contract violates the law. In fact, holding back relevant information that might undermine a company's cost estimates, even if no specific falsehood is involved, also violates the law.

The Truth-in-Negotiation Act (TINA) requires contractors to disclose all relevant information about costs to the government in sole-source contract negotiations. That way, the government can make an informed decision about what price is fair to pay for the product, since often the government can't put out the contract for competitive bids.

Some companies, fearing the government may force the price down during negotiations, inflate their cost estimates by including "pads." These inflated amounts are sometimes referred to as "management reserves" or amounts for anticipated "negotiation losses." Management reserves can be a legitimate cost item, to cover unpredictable contingencies that might arise in the course of developing and producing complex weapon systems. But they must be fully disclosed during negotiations and cannot be secretly buried in the company's cost estimates. The failure to make a full and honest disclosure constitutes a violation of TINA and the False Claims Act.

Another common type of contract fraud is "cross charging," where a company may charge employees' time or other costs associated with a fixed-price contract to a cost-plus contract. There obviously is a strong financial incentive to charge as many costs as possible to the cost-plus contract. This is particularly tempting when similar programs are ongoing simultaneously, where many tasks may arguably benefit both programs.

A more subtle type of fraud is "improper cost allocation." If a company has both government contracts and private commercial contracts, they are supposed to spread their costs fairly among the different jobs. With direct costs such as the cost of a part or a worker's time spent building a weapon, for example, this is a simple matter. When costs are less directly tied to a particular project such as supervisors' time and office space, the temptation is to shift more costs to the government and away from private customers. This allows the companies to offer lower prices to their commercial customers (gaining a competitive advantage) without having to absorb the losses for such price cuts. There are detailed and complex accounting rules that protect the government from such manipulation. Companies that violate those rules and allocate a disproportionate share of indirect or overhead costs to the government are committing fraud.

All of these types of fraud can form the basis for a qui tam case under the False Claims Act. The civil anti-fraud statute allows anyone who knows of a fraud against the government to file a lawsuit and recover damages and fines on the government's behalf. Liable defendants may have to pay as much as three times the government's losses plus $5,500 to $11,000 for *each* false claim. Individuals who file qui tam lawsuits are rewarded with 15 to 30 percent of the amount the government recovers as a result of their cases.

Since Congress strengthened the

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False Claims Act in 1986, the government has collected more than $4 billion as a result of whistleblower lawsuits filed under the law, according to the DOJ. Rewards to whistleblowers total more than $500 million.

Dealing with Fraud

There are generally three steps contract managers or other employees can take to try to stop fraud against the government.

One step is to report the fraud to superiors or to a company compliance officer, if there is one. Military contractor employees also can call the DOD hotline, which allows whistleblowers to report fraud to the government anonymously. The third alternative is to file a qui tam lawsuit under the False Claims Act. Each option has positive aspects and possibly negative consequences.

Before reporting fraud to superiors, contract managers should determine if they trust the company's internal reporting system. Company officers often are aware of the fraud and may not want anyone to raise a fuss. If that's the case, a contract manager could end up being shunted aside, reassigned to a different job, or even getting fired.

The DOD hotline gives whistleblowers anonymity. Historically, however, the DOD fraud investigation unit is often understaffed and has insufficient resources to thoroughly investigate fraud. Some hotline tips are not investigated, and investigations may go on for years for those that are.

Filing a qui tam lawsuit also has pluses and minuses. The False Claims Act requires the government to investigate charges in qui tam lawsuits and decide within 60 days whether to join the case. But the government usually gets the courts to extend the deadline for a year or more.

The False Claims Act does help protect the whistleblower's job. Qui tam lawsuits are filed "under seal," which means they are not publicly available (even to the defendant) while the government investigates. So the whistleblower remains anonymous until the government decides to join the case or not. Once the company becomes aware of the whistleblower's identity, it cannot fire or discriminate against that employee. If it does, whistleblowers are entitled under the False Claims Act to reinstatement, two times the amount of back pay plus interest, and other compensation. They also can file wrongful termination lawsuits in state courts.

So, for example, when Robert Neargarder's employer became aware that Neargarder had filed a whistleblower lawsuit, it decided to negotiate a mutually acceptable, fully-paid leave of absence for Neargarder for the case's duration. That arrangement was acceptable to Neargarder. But had he rejected it, the company could not have retaliated against him without incurring even greater legal problems.

On the other hand, inaction has its own potential pitfalls. If contract managers know their company is defrauding the government and fail to take action, they risk civil and even potential criminal action being pursued against them. Often the best assurance that the government will not target the employee is coming forward *before* the government begins its own investigation. Generally speaking, the government is predisposed to view whistleblowers as doing the right thing and is disinclined to prosecute them.

Filing a Qui Tam Lawsuit

The False Claims Act limits the time in which a lawsuit can be filed. Generally, lawsuits must be filed within six years of the date the fraud is committed, but under certain circumstances they can be filed within 10 years. The provision governing time limits is complicated and some otherwise promising cases have been dismissed because of a court's interpretation of what time limit applies.

A qui tam lawsuit can be dismissed if it is not the first one to make the allegations. It also can be dismissed if information about the fraud becomes public before the case is filed. Because the False Claims Act is a winner-take-all statute, contract managers contemplating a qui tam action may unknowingly be in a "race to the courthouse" with other company employees.

The success of a qui tam lawsuit can depend on how much experience your attorney and the government attorney assigned to the case have with fraud and the False Claims Act. The law is complicated and it often takes great diligence and effort to persuade the government the case is worthwhile. Whistleblowers and their attorneys usually need to support the government's investigation and prosecution through legal research and other assistance, such as providing evidence of the fraud and hiring experts to analyze documents. Some attorneys have entered into this area believing that they only need to file a case and sit back while the government does all the work. Both they and their clients have typically been disappointed in the results.

Qui tam lawsuits are stronger if there is documentation to support the charges. However, laws vary from state to state on what documents an employee can take from an employer. Whistleblowers should not take any original documents, but instead should make copies to give to the government. Once again, it is important to have an attorney with experience and knowledge of these laws.

Before filing a qui tam lawsuit, whistleblowers should discuss with their attorneys the pros and cons of doing so, as well as how strong the case is and whether it is likely to be successful. People take great personal and professional risks when they blow the whistle on fraud. It can be very stressful, and some cases can take years to settle. But if the lawsuit is successful, the financial reward provisions of the False Claims Act can help compensate for the risks. Whistleblowing also can give a person great personal satisfaction at having stopped wrongdoing.

A Case in Point

Robert Neargarder is a case in point. He worked for his company for 20 years. When he learned that his com-

How the False Claims Act and Whistleblower Lawsuits Work

The False Claims Act allows whistleblowers to file qui tam lawsuits on the government's behalf against companies or individuals defrauding the federal government. Liable companies or individuals may be required to pay as much as three times the federal government's losses *plus* $5,500 to $11,000 for each false claim. Whistleblowers who file qui tam lawsuits are entitled to 15 percent to 30 percent of whatever money the government recovers as a result of their lawsuits.

However, timing is important. The first person to file a qui tam action bars all subsequent cases on that same subject. That means if more than one person files a whistleblower lawsuit based on a particular instance of fraud, only the first person to file is entitled to a reward.

Types of Fraud

Many types of fraud can be the basis of a "qui tam" lawsuit:

- Presenting a false claim for payment;
- Using a false statement to get a claim paid;
- Avoiding an obligation to pay the government (reserve false claims); or
- Delivering substandard goods or services.

Employee Protection

Qui tam lawsuits are filed under seal, which means only the government knows about them until it decides whether to join a case. This gives the government time to investigate the allegations without tipping off the company.

The False Claims Act protects the jobs of "relators" (as whistleblowers who file qui tam lawsuits are called) by providing relief if the employer retaliates. This relief includes:

- Reinstatement if fired;
- Two times the amount of back pay;
- Interest on back pay; and/or
- Reimbursement of litigation costs and reasonable attorneys' fees.

State and Local Fraud

At least 10 states and the District of Columbia have similar laws that allow qui tam lawsuits if a state agency or local government is being defrauded. For more information about the False Claims Act and qui tam lawsuits, see the Web site **www.allaboutquitam.org**.

pany's R&D cost figures to the Army were grossly inflated, at first he believed there must have been some mistake. Because the company had written guidelines about raising such ethical issues, Neargarder brought his concerns directly to upper management through the company's internal channels.

Initially, he was told there was no problem. When he persisted, the company dragged its feet. Finally, after the company had negotiated a huge, multi-year $1.1 billion contract, locking in most of its inflated R&D costs as part of the fixed price, it made some of the disclosures Neargarder had insisted upon. But the company made it appear that it had not discovered the R&D underrun until well *after* the contract negotiations were concluded, which Neargarder knew was a lie. Under the rules of contract negotiation, the government was stuck with the bill.

Although the company belatedly and misleadingly made the disclosures Neargarder had wanted, it was hardly grateful to Neargarder. While the company did not fire him, his assignments became far less appealing and he noticed that he was not treated in the same manner as before. Pushing the issue to the top of the corporate structure, notwithstanding the company's written policies encouraging employees to do so, did not insulate Neargarder from retaliation, albeit in a subtle form.

Neargarder's report to the DOD hotline similarly did not produce a favorable outcome. Two years with no substantial progress can seem like a long time when an employee wonders each day if the company will discover his disclosure.

Ultimately, a qui tam lawsuit was the only viable solution in Neargarder's case. The law worked exactly as Congress had intended. Neargarder's job was protected, his allegations were thoroughly and professionally investigated, and he received a fair reward for the risks he took and the benefits he provided the government.

It doesn't always work out that way, but Robert Neargarder has been able to savor his retirement, knowing that he did the right thing and is justly enjoying the fruits of that decision. **CM**