CONSTRUCTION FIRMS: TARGETS OF ENFORCEMENT INITIATIVES

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Iraq and Katrina combine with existing trends to form a perfect storm for construction firms that have government business

The meltdowns at Enron, Tyco, Adelphia and WorldCom and many other corporate scandals have produced an explosion of legal and regulatory responses the likes of which corporate America has not seen since the Great Depression. The Sarbanes-Oxley Act of 2002 (SOX) and the related SEC and NYSE/AMEX/NASDAQ rules are probably the best known in corporate offices and boardrooms. In addition, however, a series of other legal, regulatory and enforcement activities have combined to virtually mandate that management and boards of directors of both public and private corporations that do business with the government update and/or implement comprehensive and effective corporate compliance and ethics programs. As will be seen, a comprehensive compliance and ethics program is the most cost-effective means to establish a corporate culture of integrity and fair dealing; to help personnel at all levels of the organization understand their compliance and ethical obligations; to provide a well-understood process for identifying and addressing compliance and ethics problems before they fester and, perhaps most important, before they are reported to law enforcement authorities.

Compliance and ethics programs are not a panacea and they require frequent communication and a sustained commitment. In the long run, however, the cost and effort involved are drops in the bucket compared to the massive cost of a significant compliance failure.

On top of these well-known corporate scandals, that primarily focused on publicly traded, or employee owned companies, government enforcement and regulatory activities have been further ratcheted up by the problems of the massive government actions taken in response to the War on Terror, particularly in Afghanistan and Iraq and the devastation of hurricane Katrina. Although these two situations involve all manner of federal contracting projects and dollars, a significant portion of the response to each has been the increase in procurement of construction related services, including those of design professionals. Those companies, their employees and management are now at risk if they do not take affirmative steps to insure their compliance with government contracting requirements.

There exists today a convergence of requirements that goes beyond the formal adoption of codes of ethics, codes of business conduct, disclosure controls and internal controls that are required under SOX. While these are an integral part of sound corporate governance and an effective compliance and ethics program, they are only part of what should be done. A construction company, whether public or private, today must consider the broader aspects of effective compliance programs and sound corporate governance as a result of recent guidance from the Federal Sentencing Commission and from the Department of justice to name the two most prominent sources.

Recent federal guidance

In November, 2004, the United States Sentencing Commission issued a detailed update on its guidance concerning the elements of an "effective" compliance and ethics program. This guidance has become the standard by which most corporate compliance and ethics programs have been designed and operated. In addition, the Department of Justice adopted a formal policy requiring all federal prosecutors to take into account whether or not a company has an effective compliance and ethics program in making the decision whether or not to charge that company with a criminal violation. The standard that prosecutors will use typically will be the guidance from the Sentencing Commission.

Compliance and ethics programs need to consider and integrate diverse aspects of a company's business, legal and regulatory environment that go beyond the areas covered by the financial reporting focus of the Sarbanes-Oxley Act. In today's environment, we believe that all areas of significant potential risk and exposure need to be considered and analyzed. These risks and exposures range from the more obvious areas of Foreign Corrupt Practices Act and anti-money laundering (U.S.A. PATRIOT Act) compliance to the equally important areas relating to risks created by contracting with the government in times of crisis. As will be seen, the urgency of the government's response to the war in Iraq and Afghanistan and the Katrina disaster caused the suspension of many normal contracting procedures. Many companies responded promptly to the needs caused by both situations and short-circuited their own internal procedures. In that environment, some unscrupulous persons and companies took advantage to obtain contracts they could not, or would not, perform in accordance with regulatory requirements. Spurred on by Congress, the government is now coming after those companies with a vengeance. Many honest companies will be caught up in this process and suffer through the massive costs and damage to reputation caused by being targeted for investigation.

Compliance and ethic programs

Recent developments in Delaware corporate law, in conjunction with the Sentencing Commission guidelines, have placed greater emphasis on director and officer involvement and oversight. Under these cases, including the landmark Delaware Chancery Court decision in *In re Caremark International Inc.*,[1] courts have held that directors cannot merely rely on the good faith of corporate employees, but could be held liable for failing to assure that appropriate information and reporting systems were in place at the company. The courts further suggest that directors and officers have an affirmative duty to ensure that a corporate compliance system exists, and that the absence of such a system may render directors liable for any losses caused by noncompliance with legal rules and regulations.

The importance of compliance programs in today's business environment is also underscored by statements by prominent legal jurists and writers and in commentaries to the American Law Institute's Principles of Corporate Governance ("ALI's Principles") and the American Bar Association's Model Business Corporation Act. The ALI's Principles, in addressing a director's duty of care, recognizes that compliance programs "represent a basic mechanism to assist the board in properly fulfilling its oversight role." Similarly, the ABA's Corporate Director's Guidebook recommends that directors "should assess whether the corporation has established and implemented ℓ appropriate policies designed to provide reasonable assurance of compliance with applicable laws and regulations."[2]

Ineffective compliance programs; False Claims Act liability

If the developments just outlined are not sufficient to induce construction companies that contract with the government to implement compliance and ethics programs, a recent Civil False Claims Act case in Pennsylvania should get their attention. For the first time, a federal court has held that an assertion that a company failed to maintain an effective corporate compliance program is sufficient, under the False Claims Act (FCA), to allege that the company submitted false claims with "reckless disregard" of their falsity, even though there is no allegation that upper management had *actual knowledge* that false claims were submitted.[3] As a result of this decision, *United States v. Merck-Medco Managed Care, L.L.C.*, all companies that derive revenue from federal funding should ensure that they have compliance and ethics programs and that their programs are "effective" under applicable legal standards and industry practices.

Merck-Medco Managed Care, L.L.C. arose out of a civil action brought by the Department of justice under the False Claims Act law that provides the government with powerful tools to combat fraud, waste and abuse by recipients of federal funds. Under the FCA, companies that "knowingly" submit false claims paid with federal funds are liable for *three times* the actual damages suffered by the government, plus additional penalties of up to $11,000 *per claim.* These per claim penalties alone can snowball into astronomical amounts for construction government contractors, many of which submit thousands of claims for payment each year. What makes the FCA particularly risky to companies is that the government is *not* required to prove the company had *actual* knowledge that a claim was false. Instead, a company violates the FCA if it lacked actual knowledge but is found to have acted in "reckless disregard" or "deliberate ignorance" of the truth or falsity of its claims—a much easier legal standard for the government to meet. Because of this loosened "knowledge" requirement, companies that are merely sloppy or careless in the preparation of claims that later turn out to be inaccurate can get caught in a quagmire of complex litigation and substantial liability, even though they intended no wrongdoing.

In addition, the FCA poses onerous risks for construction companies that receive federal funds, because FCA litigation can be initiated not just by the government but by *any person* who discovers or has knowledge of allegedly false claims. The FCA allows individuals to act as "private attorneys general" and file FCA actions on the government's behalf and receive a percentage of any recovery. It is not uncommon for such plaintiffs—known as *qui tam* relators—to rise from the ranks of a company's disgruntled or recently fired employees. In recent years, relators in False Claims Act cases have sometimes received tens of millions of dollars from such cases.

Iraq, Katrina and the suspension of procurement rules

When awarding contracts, the government generally uses full-and-open competition procedures to protect taxpayers' interests and reduce the opportunity for fraud and abuse. This process generally involves the receipt of competitive bids for specific tasks, followed by a government evaluation of the bids and contract award based on defined criteria. Procurement regulations include limited exceptions where the government does not need to conduct full-and-open competition for contracts. One of these exceptions is for emergency situations.

When emergencies like Hurricane Katrina and reconstruction projects in Iraq arise, the government may not have, or may claim it doesn't have, sufficient time to conduct the normal full-and-open competitions for contracts. Although fraud, or errors of judgment or analysis may arise in the normal government contracting process, the possibility of mistakes or fraud are particularly high during emergencies. In these situations, stress is high and there is tremendous pressure to demonstrate that the government is doing something to address the crisis, even if, in hindsight, it could have been done better. Thus, to meet this pressure the government may suspend certain competition requirements to expedite awarding contracts for emergency goods and services. This is what happened with the Iraq war and Hurricane Katrina: Contracts were awarded without the usual safeguards. [4]

As often happens in urgent situations, some unscrupulous contractors took advantage and padded bills, paid kickbacks to obtain work, provided shoddy goods or services, billed for goods and services that were never provided, and violated a host of other laws and regulations. In response, the government regulatory and enforcement agencies, in many cases spurred on by Congressional demands for scapegoats, have initiated investigations and enforcement actions. Some of these recent enforcement actions are described in this article.

Recent enforcement activities

There has been an increase in government contracting in recent years, including numerous contracts resulting from the war in Iraq and Hurricane Katrina. As typically found when contracting increases, the Government has also escalated its investigations into procurement fraud. Investigations generally include examining issues such as false claims, defective pricing or other irregularities in the pricing and formation of contracts, misuse of classified or other sensitive information, labor mischarges, accounting fraud, fraud involving foreign military sales and ethical and conflict of interest violations.

National procurement fraud initiative. Partially in response to Congressional inquiries and demands for anti-fraud activities, Deputy Attorney General Paul J. McNulty oversaw the creation of the National Procurement Fraud Task Force on October 10, 2006. The purpose of the Task Force is to strengthen the government's efforts to fight procurement

fraud by identifying, investigating, and prosecuting "criminals who cheat the government."[5] The National Procurement Fraud Task Force includes the Offices of Inspectors General of the relevant agencies, working in tandem with the FBI, federal prosecutors, and other defense investigative agencies. The Task Force focuses on investigating potential fraud where it may have the greatest impact: defective pricing and other pricing irregularities, irregularities in forming contracts, product substitution, misuse of classified and procurement sensitive information, false claims, grants, labor mischarges, accounting errors, foreign military sales, ethics violations, conflicts of interest, and public corruption relating to procurement.[6]

The Task Force is also focusing on developing effective strategies for preventing and detecting procurement fraud and sharing information on targets of investigations. For example, Task Force participants are using computer data-mining and other programs to uncover possible procurement fraud. They share techniques and information and, to a degree not seen before, are collaborating and coordinating investigations and prosecutions. Computer programs are being used to analyze all manner of data for trends and patterns.

Recently, the Task Force's efforts have resulted in a series of fraud and bribery cases against military and civilian personnel for their involvement in kickbacks using Iraqi reconstruction funds. Over 60 civil or criminal procurement fraud cases have been resolved or indicted since the Task Force was created.[7] Although all of these cases do not result directly from the Task Force's efforts, the Department of justice believes that "the creation of the Task Force has invigorated procurement fraud prosecutions."[8]

The Iraq war. The Office of the Special Inspector General for Iraq Reconstruction (SIGIR) is the successor to the Coalition Provisional Authority Office of Inspector General, a temporary organization created by Congress in 2004. SIGIR has the responsibility for overseeing the use, and potential misuse, of funds for reconstruction and rehabilitation activities in Iraq. SIGIR is a member of the National Procurement Fraud Task Force and regularly collaborates and shares information with the Army's Major Procurement Fraud Unit, the Department of State Inspector General Criminal Investigations Directorate, the U.S. Agency for International Development Inspector General, the Defense Criminal Investigative Service, and the FBI.

SIGIR currently has 50 auditors, inspectors, and investigators in Iraq. During the first quarter of 2007, SIGIR produced four audits, nine project assessments, and worked on 79 investigations into allegations of fraud, waste, and abuse involving reconstruction funds, 28 of which await prosecution by the Department of Justice.[9] During the past three years, SIGIR has produced 86 audits and completed 94 inspections. SIGIR has opened over 300 criminal and civil investigations, resulting in 10 arrests, a 25-count indictment of five persons, five convictions, three imprisonments, $3.6 million in restitution orders, and more than $9 million recovered.[10] Investigations have also resulted in 19 suspensions, 16 proposed debarments, and nine debarments.[11]

In its quarterly report, SIGIR noted that Congress is considering new legislation to strengthen efforts to punish fraud, waste, and abuse of funds in Iraq and elsewhere. The following bills are in the early stages of the legislative process and may undergo significant changes in markup sessions. The House of Representatives has proposed the War Funding Accountability Act, which may subject government contractors engaging in fraud or war profiteering to criminal, civil, or administrative proceedings or investigations. The Senate has proposed the War Profiteering Prevention Act, which may make it a criminal violation to profiteer or commit fraud in connection with a war, a military action, or reconstruction activities. The criminal violation would arise from making materially false statements or materially overvaluing any good or service with the specific intent to

make excessive profit. Penalties for violations may include up to 20 years' imprisonment and a fine of the greater of $1 million or twice the gross profits or other proceeds. Property traceable to a violation may be forfeited, or seized by the government. In addition, any transactions involving such property or proceeds would be subject to further charges under the Money Laundering Control Act. If enacted, these laws will subject contractors to additional liability, particularly longer jail terms.

The big concern for honest contractors is that terms such as "materially false statements" and "excessive profit" are relative concepts that are open to a broad range of interpretation. In the context of government investigations, it is ultimately the enforcement agencies and prosecutors that make the ultimate decision on whether a particular action or statement is accurate or false and whether it was taken or made with honest intent, reckless disregard of requirements, or intentionally false. As discussed below, one of the most effective ways for companies to persuade enforcement officials that their intentions were honest is to have implemented a comprehensive compliance and ethics program.

Hurricane Katrina. The specially designated Hurricane Katrina Fraud Task Force works out of the Department of Justice. The Task Force members include many of the same members as the National Procurement Fraud Task Force. It also includes the Internal Revenue Service Criminal Investigation Division, the U.S. Postal Inspection Service, the U.S. Secret Service, the Department of Homeland Security, the Federal Trade Commission, the Securities and Exchange Commission, and representatives of state and local law enforcement. The Katrina Task Force's mission is to deter, detect, and prosecute instances of fraud related to the Hurricane Katrina disaster.

In 2006, the Katrina Task Force reported that within one year of Hurricane Katrina's landfall, the Task Force's Joint Command Center reviewed and analyzed more than 6,000 fraud-related tips and complaints. [12] At that time, the Department of Homeland Security Office of the Inspector General also had over 2,000 open hurricane-related fraud investigations, with 206 arrests and 229 indictments relating to the hurricane. Other agencies were also conducting numerous audits to oversee hurricane-relating spending. In 2007, over 600 individuals have been indicted, charged, and sentenced for fraud relating to Hurricane Katrina. [13] CBS News reported that "[t]he frauds range in value from a few thousand dollars to more than $700,000." [14]

As typically found after a major disaster, many of the initial Hurricane Katrina fraud cases arose from charity-fraud schemes or emergency-assistance schemes. Once the federal government made funding available for reconstruction, the Katrina Task Force began to discover more instances of procurement fraud, such as contractors allegedly falsifying debris removal load slips. [15] Currently, the Katrina Task Force is concentrating its efforts in two areas: government-contract and procurement issues in situations where the government has spent funds on repairing and restoring the affected region; and public corruption, which generally includes situations in which public officials allegedly received kickbacks or bribes, or they were involved in extortion, or fraud schemes. Enforcement agencies believe that public corruption often accompanies procurement fraud, because contractors engaging in fraudulent schemes sometimes seek to bribe or compromise the public employees and officials who oversee the contractor's project.

CBS News has reported that "[c]complaints are still pouring in and several thousand possible cases are in the pipeline—enough work to keep authorities busy for five to eight years, maybe more." [16] Construction companies should anticipate that the government will be looking at their actions in hindsight. This means that well-meaning contractors who responded vigorously to the urgency of the situation and the pressure put on them by the contracting agencies, and bent some of the procurement rules in the interest of

getting the project in the door and completed, may face government inquiries by different agencies that don't feel the urgency and have a very different agenda. Such contractors would be wise to assess the status of their compliance and ethics programs and anticipate possible government inquiries.

Protections from compliance and ethics programs

On May 1, 2004, the U.S. Sentencing Commission (the "Commission") delivered to Congress proposed amendments to the United States Sentencing Guidelines for Organizations (the "Amended Guidelines"). The Amended Guidelines have since become law and apply to a wide variety of organizations, including corporations, partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated organizations, governments, and non-profit organizations. The section of the Guidelines on compliance programs, which is found in Chapter 8, provides for a significant reduction in criminal fines if an organization convicted of a crime has in place an "effective" compliance program. While a reduction in a criminal fine can be a useful benefit, the Department of justice has formally required prosecutors to consider an organization's compliance program in deciding whether to bring criminal charges in the first place. For good corporate citizens, this can be a significantly more important benefit.

The Amended Guidelines are intended to provide greater clarity regarding the criteria for an "effective" compliance program. The original Chapter 8 Guidelines required an organization to have an "effective" compliance program in order to receive the reduction in penalty. This meant that an organization had to have "exercised due diligence in seeking to prevent and detect criminal conduct ℓ." This, in turn, meant that an organization had to have taken the following minimum seven steps: (1) established written compliance standards and procedures; (2) assigned "high level" personnel to oversee compliance; (3) taken due care not to delegate substantial authority to persons with a propensity to engage in illegal activities; (4) taken steps to communicate its standards to employees and agents; (5) utilized auditing and monitoring systems designed to test compliance, and establishing an internal reporting system that allowed employees to report compliance violations without fear of retribution; (6) consistently enforced the compliance standards, including appropriate discipline for violations of compliance standards; and (7) taken reasonable steps to respond when violations were detected, including appropriate modifications to the compliance program.

The Amended Guidelines amplify and refine the original seven minimum requirements. The Amended Guidelines require a compliance and ethics program to "exercise due diligence to prevent and detect *criminal conduct*." (Emphasis added.) Nevertheless, in Introductory Commentary, the Commission noted: "The prevention and detection of criminal conduct, as facilitated by an effective compliance and ethics program, will assist an organization in encouraging ethical conduct and in complying fully with all applicable laws." Thus, although the formal requirement is that an effective program focus on avoiding criminal conduct, an effective program will also "facilitate compliance with all applicable laws." [17]

In one of its more controversial provisions, the Commission required an "ethical" component to be added to traditional compliance programs. It even changed the name of the program from "Compliance" to "Compliance and Ethics." This new requirement is intended to "reflect the emphasis on ethical conduct and values incorporated into recent legislative and regulatory reforms," like the Sarbanes Oxley Act. Compliance and ethics programs must now encourage and help develop an ethical "organizational culture." This provision has been controversial because the term "ethical organizational culture" is a somewhat vague and amorphous standard, and is difficult to measure objectively.

Nevertheless, the Commission felt it was very important to encourage a culture of "do the right thing," even if that is hard to define.

In addition, the Commission places specific responsibilities for the effectiveness of the program on the organization's governing authority, high-level personnel, and the compliance officer. They increase the organization's requirement to train and communicate on matters related to compliance at all levels of the organization. They also require an ongoing risk assessment, review, and where necessary, modification of the compliance program.

The revised seven elements

New language in the Chapter Eight *Introductory Commentary* addresses factors that both mitigate and ultimately increase punishment for an organization. There are six factors the sentencing court must consider when assessing an organization's culpability. Factors that aggravate the organization's culpability "are: (i) the involvement in or tolerance of criminal activity; (ii) the prior history of the organization; (iii) the violation of an order; and (iv) the obstruction of justice. The two factors that can "mitigate the ultimate punishment of an organization are: (i) the existence of an effective compliance and ethics program; and (ii) self-reporting, cooperation, or acceptance of responsibility."

The Amended Guidelines have an entirely new section that outlines the minimum requirements for an "*Effective Compliance and Ethics Program*." "Compliance and Ethics Program" is defined in the Commentary as "a program designed to prevent and detect criminal conduct." The revised seven elements are discussed below.

Standards and procedures. An organization must establish standards and procedures to prevent and detect criminal conduct. Standards and procedures include standards of conduct and internal controls reasonably capable of reducing the likelihood of criminal conduct.

Organizational leadership and culture. New language regarding organizational leadership is intended to increase leadership responsibility for compliance and to promote an organizational culture that encourages a commitment to compliance. The changes define roles and reporting relationships for specific high-level personnel with respect to the compliance program. The organization's governing authority (typically, the Board of Directors) is now required to be "knowledgeable about the content and operation of the compliance and ethics program" and exercise reasonable oversight of the program's implementation and effectiveness.

"High-level personnel ℓ shall ensure that the organization has an effective compliance and ethics program" and specific individuals among this level of personnel "shall be assigned overall responsibility" for the program. (§ 8B2.1(b)(2)(B).) The Amendment requires that an individual(s) be assigned responsibility for the "day-today" operations of the program. This individual(s) shall report periodically to the governing authority (or a subgroup of the governing authority) and shall have direct access to the governing authority (or a subgroup of the governing authority). For the first time, the Commission also requires that a compliance and ethics program have "adequate resources." (§ 8B2.1(b)(2)(C).) The meaning of "adequate resources" will vary from organization to organization, depending on the size and complexity of the organization and the levels and types of risks to which it is exposed. It is clear, however, that it will not be adequate for an organization that is large, broadly dispersed geographically and is highly regulated to assign a single employee, with additional job responsibilities, to be solely responsible for the compliance and ethics program.

Reasonable efforts to exclude prohibited persons. The organization must have employment and advancement practices that are consistent with the compliance and ethics program and promote an organizational culture that encourages ethical conduct and compliance with the law. Employee background checks and due diligence and "reasonable efforts" should be conducted, as appropriate, to ensure that the organization does not knowingly place personnel in positions with substantial authority that "the organization knew, or should have known through the exercise of due diligence, has engaged in illegal activities or other conduct inconsistent with an effective compliance and ethics program." (Synopsis of Amendment § 8B2.1(b)(3).) This provision does not automatically disqualify from employment a person with a criminal record or other unethical conduct in his or her past. However, the organization must consider the relationship of the person's past behavior to the job he or she will be performing for the organization, as well as how recent was the misconduct.

Training and communication. The Amended Guidelines require training AND the dissemination of information relevant to the compliance program and its objectives. The Amended Guidelines list the types of individuals within the organization who need to be trained, which include "the governing authority, the organizational leadership, the organization's employees, and, as appropriate, the organization's agents." The Commission was not prescriptive when addressing training; rather, it noted the need for flexibility in this area. It is clear, however, that compliance and ethics training must be delivered to senior management and the board/governing authority, as well as all employees and "agents as appropriate." (§ 8B2.1(b)(4).)

Monitoring, auditing and evaluation of program effectiveness. The Amended Guidelines require that an organization's compliance program include monitoring and auditing systems that are designed to "detect criminal conduct." There is also a requirement to periodically evaluate the compliance program itself for effectiveness. The proposed changes address the need for an organization to scrutinize two areas: (1) the adherence of the organization to legal and regulatory requirements and the compliance and ethics program; and (2) the adequacy of managerial practices and business processes to prevent and detect criminal conduct.

A reporting system is now required that will provide a means for "employees and agents" to report OR seek guidance about potential or actual criminal conduct. The language also requires that the reporting system incorporate a non-retaliation policy and allow for anonymous and/or confidential reporting. (§ 8B2.1(b)(5).)

Performance incentives and disciplinary actions. The organization must consistently enforce the compliance and ethics program throughout the organization using incentives to encourage employees to perform in accordance with the program AND the use of appropriate disciplinary measures for engaging in or "failing to take reasonable steps to prevent and detect criminal conduct." This should include making compliance and ethics part of employee and management evaluations and promotions. (§ 8B2.1(b)(6).)

Remedial action. Once an organization detects criminal conduct, it must take reasonable steps to respond appropriately AND prevent further criminal conduct including modifying the compliance and ethics program. (§ 8B2.1(b)(7).)

The eighth element: Risk assessment?

Although the Commission did not formally designate an eighth element, preferring to continue with the well-established concept of seven elements, it did state, "as an essential component of the design, implementation and modification of an effective

program, ℓ an organization must periodically assess the risk of the occurrence of criminal conduct." (§ 8B2.1(c).) Organizations must periodically assess the risk of criminal conduct and take appropriate steps to design, implement or modify compliance procedures to reduce the risk of misconduct identified through this process. Critical to the risk assessment are the following elements:

- Assess the nature and seriousness of potential improper conduct.
- Evaluate what reasonable steps can be taken to prevent and detect the specific kinds of improper conduct to which the organization is exposed.
- Consider the prior history of the organization and others similarly situated: appropriate consideration should be given to prior criminal, civil and regulatory enforcement actions.
- Periodically prioritize the program elements in order to focus on preventing and detecting the improper conduct most likely to occur.
- Modify, as appropriate, the procedures to be taken under any of the program elements to reduce the kinds of improper activity most likely to occur.
- Train management and employees to be aware of and report the kinds of violations most likely to occur.
- Develop auditing and monitoring programs focused on the violations most likely to occur.

Relevant changes to the guidelines: Potential pitfalls

In addition to the revised seven elements, several other new provisions should be noted.

Adoption of industry standards/government regulation. The Commentary of §8B2.1 states "an organization's failure to incorporate and follow applicable industry practice or the standards called for by any applicable governmental regulation weighs against a finding of an effective compliance and ethics program." (Application Note 2(B).)

Mitigation of criminal fines. Under § 8C2.5(f), an organization will not get credit for the existence of an effective compliance and ethics program if:

- after becoming aware of an offense, it unreasonably delayed reporting the offense to government authorities;
- an individual within "high-level personnel" of the organization or a unit of the organization where the offense was committed participated in, condoned or was willfully ignorant of the offense.

Cooperation and acceptance of responsibility. The Amended Guidelines also provide for a reduction in an organization's "culpability score" for self-reporting, cooperation and acceptance of responsibility. (See § 8C2.5(g).) To receive this credit, the organization's cooperation must be "timely and thorough." This, in turn, requires the "disclosure of all pertinent information known by the organization." (See Application Note 12.)

Upward departures. There is new language that states an "upward departure" (a more severe sentence) may be warranted if an organization was required by law to have an effective compliance and ethics program but did not. This provision is relevant to government contractors because of proposed amendments to the Federal Acquisition Regulation that would require many contractors to have compliance programs.

Corporate probation. The Amended Guidelines require the court to order a term of probation if the organization had 50 or more employees at the time of sentencing, or was

required under law to have an effective compliance and ethics program and didn't have such a program. Under this provision, companies will have compliance programs imposed on them by the government or the courts. These programs are typically much more extensive and expensive to operate than programs voluntarily established by organizations themselves.

Violations of probation. A policy statement has been added that states if an organization is found to be in violation of a condition of probation the court may: 1) extend the term of probation; 2) impose more restrictive conditions of probation; or 3) revoke probation and re-sentence the organization. The Commentary to the section further states that: "in the event of repeated violations of conditions of probations, the appointment of a master or trustee may be appropriate to ensure compliance with court orders." Appointment of such masters is becoming more and more prevalent.

Department of Justice policy

As noted above, the Department of justice has established a policy on prosecuting corporations that requires federal prosecutors to consider whether a company has an effective compliance and ethics program in making the decision whether or not to criminally prosecute the company. It is clear from the Department of justice's perspective, for a compliance program to achieve the highest benefit for a corporation it must be designed to ensure compliance with "all applicable criminal and civil laws, regulations and rules." Thus, a program that focuses only on criminal conduct may not be sufficient. In addition, prosecutors are directed to look beyond the paper documents that form the underpinning of a compliance program. Like the Amended Guidelines, prosecutors will want to see adequate staffing and resources, well-designed training, auditing and monitoring programs, true corporate commitment to compliance, an informed and involved senior management and board, and other elements which make the program effective and more than a mere piece of paper. The Department also directs prosecutors to consider whether or not the program has been "designed to detect the particular types of misconduct most likely to occur in a particular corporation's line of business." In other words, they will want to see a risk assessment and a program designed to protect against the risks identified.

Over the past decade and more, prosecutors and a broad range of regulatory enforcement agencies have developed experience in evaluating compliance programs. Their reviews of compliance programs are becoming more and more sophisticated. It is also clear that the standards by which prosecutors will evaluate compliance programs are, and will continue to be, the standards set forth in the Sentencing Guidelines. As a result, organizations with either existing compliance programs, or programs that are being developed for the first time, will obtain the most benefit from their compliance efforts if they utilize the Amended Guidelines in both the design and implementation of their programs.

Conclusion

The combination of new statutes and regulations directed at combating corporate fraud and the government's particular efforts in response to perceived substantial amounts of procurement fraud in response to the Iraq war and the Hurricane Katrina disaster, have resulted in tremendous investigative attention on government contractors, particularly those in the construction and professional services industries. In our experience, the most effective way for companies to protect themselves when this kind of scrutiny comes is to have an effective compliance and ethics program. The time to develop and implement a program is before the investigation begins. The government looks with some

skepticism at the motivation of companies that begin the implementation of compliance and ethics programs *after* they learn of an investigation or allegation of fraud. Construction firms involved in government contracting, whether focused on the war or Katrina response or not, are on notice of the kind of programs the government expects to see, and they should safeguard their investors, management and employees accordingly.
[1]

In re Caremark International, Inc. Derivative Litigation, 698 A.2d 959 (Del. Ch. 1996).
[2]

The importance of the board's involvement in insuring that an effective compliance and ethics structure exists is brought home by the recent settlement negotiations in the MCI and Enron shareholder actions, in which members of the boards of directors have been asked to contribute millions of dollars of their personal assets toward the settlements, in addition to the amounts available through Director and Officer liability insurance policies.
[3]

United States v.. Merck-Medco Managed Care, L.L.C., 336 F.Supp.2d 430, 440-41 (E.D. Pa. 2004).
[4]

Testimony of David M. Walker, Comptroller General of the United States, before the Committee on Oversight and Government Reform, House of Representatives, February 15, 2007, page 10.
[5]

National Procurement Fraud Task Force website, available at http://www.usdoj.gov/criminal/npftf/*http://www.usdoj.gov/criminal/npftf/*.
[6]

Id.
[7]

See id.
[8]

Statement of Barry M. Sabin, Deputy Assistant Attorney General, Criminal Division Department of Justice, before the Committee on the Judiciary, United States Senate (March 20, 2007), available at ; http://judiciary.senate.gov/testimony.cfm?id=2598&wit_id=6179*http://judiciary.senate.gov/testimony.cfm?id=2598&wit_id=6179*
[9]

April 2007 Quarterly Report, Stuart W. Bowen, Jr., Inspector General (April 30, 2007), available at . http://www.sigir.mil/reports/quarterlyreports/Apr07/Default.aspx.*http://www.sigir.mil/reports/quarterlyreports/Apr07/Default.aspx*.
[10]

See id.
[11]

Id.
[12]

Hurricane Katrina Fraud Task Force, *First Year Report to the Attorney General, September 2006*, page 4.
[13]

See DOJ Press Releases available at http://trina/Katrina_Fraud/pr/press_releases/*http://trina/Katrina_Fraud/pr/press_releases/*; *Thousands Suspected of Katrina Fraud*, CBS News (April 2, 2007).
[14]

Thousands Suspected of Katrina Fraud, CBS News (April 2, 2007).
[15]

Hurricane Katrina Fraud Task Force, *First Year Report to the Attorney General, September 2006*, pages 5, 14.

[16] *Id.*

[17] *Id.*