THE FOURTEENTH MAJOR FRANK B. CREEKMORE LECTURE[1]

BRIGADIER GENERAL (RET.) RICHARD J. BEDNAR[2]

5 December 2002

Thank you for that warm and generous introduction. I can hardly wait to hear what I have to say. I am glad for a couple of things this morning. Number one, I did not fall and drive cinders into my face as I did one time when I was scheduled to speak at the JAG School. That was the running accident I had that was mentioned a moment ago. Second of all, I was sit-

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1. This is an edited transcript of a lecture delivered by Brigadier General (Retired) Richard J. Bednar to members of the staff and faculty, their distinguished guests, and members of the contract law community attending the Government Contract and Fiscal Law Seminar at The Judge Advocate General's School, Charlottesville, Virginia, on 5 December 2002. Not reproduced here are the charts Mr. Bednar displayed in support of his lecture. The Major Frank B. Creekmore Lecture was established on 11 January 1989. The Lecture is designed to assist The Judge Advocate General's School in meeting the educational challenges presented in the field of government contract law.

Frank Creekmore graduated from Sue Bennett College, London, Kentucky, and from Berea College, Berea, Kentucky. He attended the University of Tennessee School of Law, graduating in 1933, where he received the Order of the Coif. After graduation, Mr. Creekmore entered the private practice of law in Knoxville, Tennessee. In 1942, he entered the Army Air Corps and was assigned to McChord Field in Tacoma, Washington. From there, he participated in the Aleutian Islands campaign and served as the Commanding Officer of the 369th Air Base Defense Group.

Captain Creekmore attended The Judge Advocate General's School at the University of Michigan in the winter of 1944. Upon graduation, he was assigned to Robins Army Air Depot in Wellston, Georgia, as contract termination officer for the southeastern United States. During this assignment, he was instrumental in the prosecution and conviction of the Lockheed Corporation and its president for a $10 million fraud related to World War II P-38 Fighter contracts. At the war's end, Captain Creekmore was promoted to the rank of major in recognition of his efforts.

After the war, Major Creekmore returned to Knoxville and the private practice of law. He entered the Air Force Reserve in 1947, returning to active duty in 1952 to successfully defend his original termination decision. Major Creekmore remained active as a reservist and retired with the rank of Lieutenant Colonel in 1969. He died in April 1970.

ting up here on this stage, with one leg over the other, and I said, "Thank God my socks match today," which is not always true, is it?

When I agreed to be your Creekmore lecturer, I had heard about this event. I was very much taken with the fact that a number of very distinguished persons have preceded me, almost all of whom I know personally, which says only that I have been around in this business for a very long time. But then I read the fine print, and I saw that long ago Major Creekmore actually pursued a fraud case against one of our clients. I wondered whether I had to get a conflict clearance in order to come here and make this presentation. But those were days long ago. Lockheed is now part of Lockheed Martin, of course, and a leading aerospace and defense contrac-

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2. Brigadier General (Ret.) Bednar is Senior Counsel to the Washington, D.C. office of the law firm of Crowell & Moring LLP, where he specializes in the government contract law areas of contract claims, internal investigations, ethics and compliance issues, and suspension and debarment.

Before his retirement in 1984, BG (Ret.) Bednar served in a variety of Army JAG assignments, including the Administrative Law Division, Office of The Judge Advocate General; the Litigation Division; Contract Appeals Division; Procurement Agency, Vietnam; Judge Advocate, U.S. Forces, Korea; Judge Advocate, U.S. Army, Europe; and Assistant Judge Advocate General for Civil Law.

Brigadier General (Ret.) Bednar is a graduate of the Creighton University School of Law, and holds a Master of Law degree from the National Law Center, George Washington University.

Brigadier General (Ret.) Bednar is active in the Public Contract Law Section (former Council member), American Bar Association, and in the programs of the National Defense Industrial Association. He is a Fellow of the National Contract Management Association. In 1989, as a consultant to the Administrative Conference of the United States, he prepared and published a study titled *Government Contracting Officers Should Make Greater Use of ADR Techniques in Resolving Contract Disputes*. He is a co-author of the book *Construction Contracting*, published in 1991 by George Washington University, and a co-author and executive editor of the ABA publication, *The Practitioner's Guide to Suspension and Debarment*, published in July 2002.

In January 1999, he was appointed the national Coordinator of the Defense Industry Initiative on Business Ethics and Conduct (DII), and is active in defense industry ethics and compliance matters.

In 2001, BG (Ret.) Bednar was appointed as a member of the United States Sentencing Commission, Ad Hoc Advisory Committee on Corporate Sentencing Guidelines.

tor insofar as procurement dollars are concerned, and certainly a leader of the DII.

What I have tried to do and what I intend to do with you for the next hour and a half or so is to build on the theme of Creekmore's legacy, and that is a judge advocate who took on government contract fraud, and also a theme that is in keeping with the general subject of this seminar, namely, the Contract and Fiscal Law Seminar. So I have gone back in history for twenty years, and in doing that I do not mean to suggest for a moment that we had no contract fraud in the Defense Department prior to twenty years ago. I am not suggesting that at all, but we needed a beginning point. I could have gone back to the Revolution because I am sure the farmers were ripping off the Patriots as they marched into battle even then because the history of government contracting is a history of abuse and reform in a very real sense. I went back twenty years, first of all, because that spans a very interesting time frame, and also it gives us a reasonable period of time within our history to consider.

Another reason for going back twenty years is that the early 1980s were really the best of times in a very real sense. Procurement dollars were literally pouring into the Pentagon at a rate faster than they could be wisely spent. This was the Reagan era. President Reagan's vision was to build up our national defense apparatus so that we would eventually end the Cold War in one way or another. I do not think Reagan ever had in mind exactly the way the Cold War did end; namely, by the implosion of the Soviet Union in circumstances where we literally outspent them.

I do not think that President Reagan ever had that vision, but I do think that by building up the defense of this country the way he did in the early 1980s, it contributed strongly to the demise of the Soviet Union and the end of that era. It was a boom period in defense spending; literally a billion dollars a day were being poured into not only procurement, but were also being spent by the Defense Department. We had the vision of a 600-ship Navy, and a lot of aircraft were under development and were going into production. So those were the good times.

In addition to that, the early 1980s were, in a very real sense, the worst of times because the defense industry was mired in corruption, both inside and outside the Pentagon. The typical form of wrongdoing in the early 1980s was that unscrupulous procurement executives, all of whom were civilian and none of whom were Army, if that should make any difference to our consideration, would steal and convert to their own use precious

procurement information and sell it to corrupt "consultants" outside the Pentagon who, in turn, would resell that precious procurement information to defense contractors. Some of these defense contractors bought it unwittingly, not knowing that the information they were buying from the consultant was acquired in the manner I just described. But, I think a number of them also knew that what they were buying had to have been stolen from within the procurement planning apparatus within the Pentagon. It was terrible corruption. Not only that, but it was also an era when bribes and gratuities were frequently being paid in order to steer the award of important defense contracts to the payer of the bribes and the gratuities.

Again, the corruption was not limited to defense contractors alone. The corruption extended, unfortunately, to within the walls of the Pentagon, as well. You will remember some of these instances, I am sure. Some of you are old enough to remember the era of the four-hundred dollar hammer, the seventy-four hundred dollar coffee maker, and some of those other abuses. I can remember the four- or five-hundred dollar toilet seat. Those were some of the abuses that were going on. Incidentally, we looked into the reason why the coffee maker for the C-5A aircraft cost so much, and the real reason is that it was designed to withstand 17 Gs. When you design anything to withstand 17 Gs, that is going to cost a lot of money. Now the wings of the airplane would fall off at 17 Gs, but the coffee maker would survive, so the aircraft accident investigators would be assured of hot coffee when they arrived on the scene. That is the inside story about that. So, again, that was a time of abuse.

Another reason for these expensive spare and replacement parts, quite frankly, is that too often the people inside the Pentagon were lazy. They would order these things from the aerospace contractor. For example, if you order a box of screws from the XYZ Corporation, and they pass it through all of their engineering and evaluation and acquisition process and add all that overhead to it, you are going to come up with a pretty expensive end item. That is part of the explanation why the spare parts in particular cost so much money.

Operation Ill Wind was the largest procurement fraud investigation in the history of our nation, bar none. "Operation Ill Wind" was the term used because that investigation was initiated to pull us out of the mire. The operation was led by a colleague named Henry Hudson, who at the time was the U.S. Attorney for the Eastern District of Virginia. Cases brought involving defense procurement fraud quite commonly are brought in the

District Court for the Eastern District of Virginia because of its proximity to the Pentagon.

Here are some statistics illustrating the magnitude of the investigation. Operation Ill Wind involved a thousand investigators and prosecutors. Many of the investigators, by the way, were Defense Criminal Investigative Service (DCIS) and Army CID personnel. I do not know if we had any judge advocates involved in that or not, quite frankly. Over 800 subpoenas were issued by the grand juries (plural) that Henry Hudson worked with, and the investigation included two million documents. Ninety companies and individuals were ultimately convicted, and a good number of those were debarred from government contracting. This whole process took a long number of years. They were still gaining convictions when I went to Crowell & Moring in 1987. Operation Ill Wind was still bearing the fruit of its efforts.

With respect to the wire taps, they got authority to wire tap a number of people inside the Pentagon and some of these consultants. The first couple of weeks after I went to Crowell & Moring in 1987, I had occasion to listen to some of those wire taps because the firm was representing some of these individuals who ultimately were prosecuted, and some of them were convicted. The funniest one I remember is a discussion between a guy on the outside and this procurement executive inside the Pentagon. The conversation goes something like this: "Did you deposit the money yet?" "Yeah, it's been deposited." "Where is it?" "Well, just like we arranged. It's deposited in your Swiss banking account." "My Swiss banking account, huh? Is that right?" "Yeah." At the other end, "Well, tell me how do I get the money out?" So as sophisticated as some of these crooks were, they didn't know the answer to that question; and by the way, the guy on the phone didn't know either. So that was always an entertaining thing to consider.

The major forms of wrongdoing that were unearthed during this era—we are still in the early 1980s—were these crimes: bribery and illegal gratuities; misuse of procurement information; mail and wire fraud; a lot of conversion of government documents, including classified documents, which was the subject of a companion investigation because there were so many classified documents that were stolen and sold under this process that I earlier described to you; and, of course, false claims and false state-

ments. The Office of the U.S. Attorney did a wonderful job and eventually cleaned that mess up.

I think, and you will agree with me after we go through the review that I am about to make, that in the last twenty years we have seen more success in combating procurement fraud, and we have had fewer scandals and problems. I really believe that. I really believe that we have risen from the mire of twenty years ago. It has been a slow process. It has taken a lot of resources. It has taken a lot of new statutes and regulations, but the defense industry has pulled out of that mire. At the same time, I personally fear that we are on the edge of the mire again, and I think there is a real danger that we are about to slide into that slop in short order. Why do I say that? Well, first of all, almost all of our investigative resources at the federal level are now being devoted not to procurement fraud, but to chasing the terrorists—to the anti-terrorist campaign. That is particularly so in the Federal Bureau of Investigation (FBI). The FBI has almost no resources dedicated to Army procurement fraud or to Defense procurement fraud anymore. They are all after terrorists.

Second of all, we are getting away from the discipline of full and open contracting. Look at where the defense dollars are going today. They are not going through the competitive contracting process that we were familiar with for so many years. The game now is that when an agency gets a contract awarded successfully, it keeps loading additional tasks, works, and transfers of funds onto that contract. The use of "other" authority, instead of using the procurement statutes and the Federal Acquisition Regulation (FAR), is growing by leaps and bounds. More procurement dollars every year are awarded on the basis of pre-existing contract vehicles or other authority than there are through the traditional competitive contracting practice.

We have seen some abuse already in the use of government credit cards, and we will see more of that. I think that the investigation into that area has yet to be unfolded thoroughly, and we will find even more abuse than we have been reading about recently.

Another thing we have done: we have raised the authority to use the simplified acquisition procedure for commercial items to five million dollars. Come on. That is just asking for abuse. We are contracting out more and more all the time, which means that we are removing the responsibility

and the accountability to outside of the government organizational apparatus and into the commercial sector.

The notion of partnering is another area that I think is rife with risk for improper conduct. Anytime you have contractor and Department of Defense (DOD) personnel working shoulder to shoulder, side by side, the same desk, there is bound to be some crossover of precious information that should not crossover. There is bound to be some abuse of conflict of interest protections—invitation for a renewal of a revolving door, and what have you. That is just not our experience. Our experience is a formal, arms-length relationship between the contracting partners works best. Let them be partners, let them work shoulder to shoulder to pursue the objective of the contract. I am not quarreling with that. But we should return, I think, to a more arms-length contract relationship.

Finally, for those of you who have read the Homeland Security Act,[3] you know that there are a zillion loop holes in that statute as well. There probably are a number of government contractors in the Washington area who are just licking their chops to get in to that; it is going to open up a lot of abuse that we have not experienced before.

So that is why I think we may be on the edge of the mire again. We need to be vigilant; we need to work together; we need to be sensitive; and we need to be circumspect and make sure it does not happen.

Back to 1982. One of the highlights of 1982: Admiral Rickover retires. This guy had sixty-three years of active duty. I will leave it up to you fiscal law guys to figure out what his retired pay must have been, but if it was two and a half percent per year, that is a pretty good plus-up for retiring. The guy was on active duty until he was eighty-two. That is a terrific, long period of time.

Admiral Rickover was a very controversial guy. On the one hand, he was a hero. He was the father of the nuclear Navy. On the other hand, he was sharply criticized for accepting gratuities and being too cozy with his favorite contractors. In fact, he was once quoted as saying that high-priced law firms can probably avoid almost any contract, probably even the Ten

3. Homeland Security Act of 2002, Pub. L. No. 107-296, 116 Stat. 2135.

Commandments. His retirement marked the end of an era; there is no question about that.

At one time it was my pleasure to serve as the judge advocate in Korea with General Jack Vessey, who later became the Chairman of the Joint Chiefs of Staff, twice as a matter of fact. I remember being out with General Vessey one time when he was giving the troops of the 2d Infantry Division a lecture on ethics and morality, which he did from time to time. He was a very spiritually devout person, and I remember his punch line talking to these troops. Vessey said, "And just because you're 5000 miles away from home does not mean that there is a king's X on the Ten Commandments." That seemed to resonate with the troops. I think they understood that.

Senators Levin and Cohen were really pushing in 1982 for a greater use of debarment. I happened to have been the debarring official in 1980 and 1981, I think. Then there was a break, and then I went back to do it again; but I was one of the debarring officials called on the carpet by Levin and Cohen in their hearings. They had a whole litany of convictions, sort of like the POGO list that most of you are familiar with, a list of defense contractors which had been convicted of contract fraud and would still get contracts. In any event, they really pushed us hard, all of us—Army, Navy, Air Force, Defense Logistics Agency—to pull up our socks and use the protective measure of suspension and debarment to an extent that was unprecedented.

Before 1981-1982, when Levin and Cohen had these hearings, we did not use suspension and debarment very often. As the Assistant Judge Advocate General for Civil Law, I was the debarring official. I am trying to remember how many debarment cases would be presented to me in a given year. I think it was somewhere in the neighborhood of fifteen or twenty, no more than that. It was a remedy that was always there in the regulations, but never used. For some reason the field and Army policymakers never brought it up. It was not peculiar to the Army, either. It was a condition that existed also in the other services. It took these two courageous lawmakers, Cohen and Levin, to dig in and find out that this remedy was not being used. They put some heat on us to actually begin using the remedy to a greater extent than we ever had before.

Also in 1982, the Office of Federal Procurement Policy issued a letter that for the first time discouraged pinpointing a suspension or debarment to a particular facility or particular operating unit, but rather to take out the

whole company. It is a recognition that you have to look at the culture of the company; you have to look at the company's corporate attitude, if you will, to see how relevant that is to the problem that brought the company in harm's way with suspension or debarment. That policy letter also for the first time established some evidentiary standards: a preponderance standard for debarment and an adequate evidence standard for suspension. Those standards remain viable today, but we did not really have it voiced and articulated until this policy letter of 1982, twenty years ago. The letter also made it clear that if anyone pled nolo contendre, that that was equivalent to a plea of guilty and would provide an adequate predicate for suspension or debarment.

About the same time, the Department of Justice (DOJ) and DOD began to get together and figure out jointness in investigating and going after procurement fraud. The first two guys who linked arms in that endeavor were Dick Sauber and Mike Eberhardt. Dick Sauber came from the Criminal Division of the Department of Justice, and is now in private practice with the D.C. law firm of Fried, Frank. Mike Eberhardt was from the DOD and had been an Assistant Inspector General of the Defense Department. Mike served for a period of time in this capacity with Sauber and successors from the Criminal Division, and he is now also practicing with a D.C. law firm.

Also in 1982, for you fiscal law guys, you may remember that for the first time we said, "Hey, why should we make legal costs or the cost of defense against fraud allowable costs?" The regulations were therefore changed so that if you defended yourself, the cost of doing that would be totally unallowable if you lost. Even if you won, you only got to recover eighty percent. I believe that is still in FAR part 31; that is still one of the principles on the allowability of costs.

The DOD also finally got around in 1982 to formalizing its DOD hotline, which had been established in 1979. This is a hotline to receive reports from anywhere within the Defense Department or otherwise on suspected fraud, waste, or abuse. It was a huge initial success, and it still is. It is still widely used, probably to a little lesser extent than before because: (a) all the agencies now have hotlines and not just DOD; and (b) a number of corporations have hotlines so that some of those reports go into the company's system rather than directly to the DOD.

1982 was also the year that the DCIS was established to concentrate on white-collar crime, with special agent training to take on contract fraud

matters. We did not have any training in contract fraud twenty years ago. It just was not there. There may have been an occasional short course at the JAG School from time to time, if you were lucky enough to have funding to go, and if they had offered it at a time when you could be there, but there was no formal training. The investigators had no formal training either, but it all got started twenty years ago in 1982.

There was a time in the JAG Corps, frankly, when unless you were trying courts-martial, unless you were in military justice, you were second rate. I spent much of my time trying cases before the Armed Services Board of Contract Appeals and in related endeavors, so we were really not the front-runners, if you will. The front-runners were in military justice. Military justice knew about fraud, but not in the context of procurement fraud. So this was a big change that we in JAG would finally get some formal training in contract fraud.

1982 also marked the enactment of the Victims and Witnesses Protection Act,[4] which in a small way contributed to the war on defense procurement fraud because it provided for restitution to agency victims. In most situations now when the defense contractor settles a civil false claims case with the U.S. Attorney or with the DOJ, they will insist on restitution. The predicate for that began twenty years ago.

In 1983—we have moved ahead a whole year now—the bill was introduced to authorize agencies to charge administrative penalties. This eventually led to the Program Fraud Civil Remedies Act (PFCRA),[5] which has never been used very much. The procedure is very awkward, and there are very few situations when the decision-makers think it is appropriate. The idea and the concept is a good one, however, and I think that with some more streamlined procedures, it has a place. The whole concept was that we had to have a mechanism for dealing with "smaller" frauds: cases that the typical U.S. Attorney would turn down because they have limited resources and are not going to pursue it unless it is worth millions of dollars. So the whole concept of the Program Fraud Civil Remedies Act was to deal with those smaller ones and to give the agencies the authority to

4. 18 U.S.C. § 1512 (1982).
5. 31 U.S.C. §§ 3801-3810 (1982 & Supp. IV 1986).

have a little due process and have the authority to enact some actual administrative penalties, but it is not used much.

Executive Order 12,448[6] issued in 1983 authorized regulations to rescind contracts. Then finally, a very seminal event in the Army, at least, happened in July 1983, when The Army Judge Advocate General for the first time established a Contract Fraud Branch. At that time, it was located in the Litigation Division and led by Dick Finnegan. Dick is now a lawyer with the Defense Logistics Agency and a very good person. He still involves himself in defense contract fraud issues. It was also led by Kevin Flanagan, a lawyer with the DOD IG's office. Those guys really got, in a branch setting, the Army procurement contract fraud going. Later, of course, it became a Procurement Fraud Division. I understand by rumor that it may be squeezed down to a branch again because of the impetus to move people to the war fighters and to size down the "overhead" and the number of lawyers devoted to these activities. What is now the Procurement Fraud Division, and a very successful one I will say, may indeed shrink down to branch size in the near future.

Now back in 1982, before this began, I was the Judge Advocate of Europe. While in that position, I helped start what I called the Contract Fraud Coordinating Committee because we had no mechanism for integrating our attack on government contract fraud in Europe until that time; it was an ad hoc thing. We would get together once every couple of weeks with the Judge Advocate; the chief of contract law; the head of the Army's CID for Europe; the head of the Provost Marshall for U.S. Army, Europe; the auditors; and the head of contracts. We had about eight people, and we would get together and review incident reports that would come in. Most of these involved construction contracts in Europe where the contractor was somehow "shorting" on its deliveries, either in quality or quantity, and so we took a coordinated approach.

Some of those companies for the first time we debarred. We had authority in Europe at that time to debar them—we did not have to come back to Washington—and some of those we reported to the German authorities for prosecution. So for the first time we took a whack at it in a

6. Exec. Order No. 12,448, Exercise of Authority Under Section 218 of Title 18, United States Code, 48 Fed. Reg. 51,281 (Nov. 8, 1983).

way that was later to grow into what was the Procurement Fraud Division. Those were pioneer days.

Now a great blow for combating fraud occurred when I retired in 1984, and they finally got somebody in the job who knew what he was doing. The competency and the attention to defense contract fraud certainly grew by leaps and bounds at that time. 1984 saw a lot of headlines. A big fuss over Rickover occurred when Electric Boat was prosecuted for providing gratuities to Admiral Rickover and to Mrs. Rickover. Some of the charges were pretty outrageous. This was at a time when Rickover was feeding contract work to Electric Boat, so it was a terribly scandalous situation. The word "fuss" is certainly an understatement of the attention that it got at that time.

We also had the Defense Procurement Reform Act of 1984,[7] which says, "Up at the front end when you're designing systems—defense systems, electronic systems—do it in a way that promotes competition and not in a way that it's going to go to one source." Those are marvelous ideas—hard to implement, in fact—but they were marvelous ideas, aimed again to try to promote competition.

Then finally, remember all the spare parts scandals. We had this Small Business and Federal Procurement Competition Enhancement Act of 1984,[8] which says, "Hey, if you're a prime contractor, you can't limit your sub to sell to you only. You must let the sub go direct to sell to anybody else or direct to the agency." These direct sales to the Defense Department were a big step forward in reducing the cost of spare parts and replacement components. All this sounds so logical today, doesn't it? So simple and so logical, and yet it grew over the last twenty years. It did not happen overnight.

In 1985, the DOD published a list of thirty-six defense contractors who were under investigation; most of those were for mischarging. That is a lot, though, to be under investigation at one time. Then we had a kind of a misplaced policy, in my judgment. Will Taft was the Deputy Secretary of Defense, and he put out a letter that said any contractor who is convicted of a felony connected with a contract will be debarred, no discretion, for at

7. Pub. L. No. 98-525, 98 Stat. 2588 (codified as amended at scattered sections of 10 U.S.C. (1982 & Supp. III 1985)).

8. Pub. L. No. 98-577, 98 Stat. 3066 (codified as amended at 10 U.S.C. §§ 2302, 2303a, 2304, 2310, 2311; 15 U.S.C. §§ 637, 644; 41 U.S.C. §§ 251 note, 253, 253b-253g, 259, 403, 414a, 416, 418a-418b, 419).

least one year. Well, that did not sit very well with other contract agencies or the contractors, as you can imagine. It seemed a bit out of balance with reality because quite often a contractor was as much a victim as the Defense Department. That is to say, the contractor tried to do everything right—the right policies, controls, procedures, and training. Yet some scoundrel, some rotten apple in the barrel, would commit a fraud. Of course, that makes the company criminally liable; that is U.S. Law.

Within a few months, that policy proved unworkable. Instead the FAR published a list of mitigating factors which the debarring official could—not must—could consider in determining whether to debar, and if so, what the duration should be. We pretty much have that rule today. There is no automatic one-year debarment. Unless it is in the area of violation of the Clean Air Act or Clean Water Act, the duration is a discretionary one, and we are still there.

As a matter of fact, we have the same rule with the non-procurement debarment. Non-procurement debarment, which is really a big area because it has to do with grantees and a lot of money, particularly from HUD, the Environmental Protection Agency (EPA), and Health and Human Services (HHS), is distributed not by contract, but by grant. So there is this whole separate set of regulations called a common rule that govern non-procurement suspension and debarment. The regulations as non-procurement document not only list mitigating factors, but also a list of aggravating factors. I think this is a plus, and maybe we will see that repeated over into the FAR someday.

The year 1986 also saw fifty-nine of the top one hundred contractors under investigation for fraud. Isn't that pathetic? Fifty-nine out of a hundred. At the same time, President Reagan had appointed David Packard from Hewlett-Packard, who was then the Deputy Secretary of Defense, to head up a blue-ribbon panel on management of the Defense Department. Concurrent with Packard and in coordination with his work, thirty-two CEOs of leading defense contractors decided that they needed to do something industry-wide.

So for the first time in history, these defense leaders got together and decided to form an association which became known as the Defense Industry Initiative on Business Ethics and Conduct. The whole concept was, "Look, we as an industry really have been in a mire. We have lost the confidence of the Congress. We have lost the trust of the American people. The defense industry is being prosecuted for absolutely shameful conduct,

and no amount of laws and regulations is going to change that unless we have an attitude change, a culture change within the industry itself. The real answer is to aggregate ourselves, to pull up our socks and decide that we as an industry are going to embrace and practice ethical business conduct as a discipline so as to restore that trust and confidence."

That was the birth, if you will, of the DII, the Defense Industry Initiative on Business Ethics and Conduct. Thirty-two at the beginning, and the DII is now at fifty. By the way, I do not know how many of you read *Defense Week*. But if you look on page sixteen of this week's *Defense Week*, dated Monday, 2 December 2003, it has a chart illustrating twenty years of defense industry consolidation. If you go down the left side of the chart, you see that there were seventy-three major defense companies involved in this process of consolidation over twenty years ago. We are now down to Lockheed Martin, Boeing, Raytheon, Northrop Grumman, and General Dynamics, the big five. Not the final four like we have in the accounting industry. We had the big five in the accounting industry, and now after Arthur Andersen, we have the final four.

Think about that great consolidation, in twenty years. That is a tremendous statistic, evidencing a substantial consolidation of the industry. Seventy-three now melted into five; that is not to say that there are only five defense contractors, but these five defense contractors represent what was seventy-three separate companies a mere twenty years ago.

Looking at the principles that DII adopted in 1986 reflect what defense contractors expect of themselves. It is an expectation of what a defense contractor should do. If you look in DFARS 203.7000, you will see expressed the similar expectation that a defense contractor will have standards of conduct. It all came from the DII. The DII was there first. Later on, the U.S. Sentencing Commission also picked up on the DII's concept of insistence on ethical conduct.

It seems so simple. The defense contractor is expected to establish a code of ethical conduct that represents the most precious values of the company, what the company believes in, what the company is all about. The Code is applied to everybody, including employees. It is now being applied to major subcontractors as well. You also have ethical conduct training, an internal means for reporting misconduct, and a procedure for self-disclosure to the government. Now, this is not the same thing as the DOD Voluntary Disclosure Program. It means a self-disclosure to the government, and that can take many forms: a disclosure to the contracting

officer, or if appropriate, to the DOD IG; sharing best practices; and then public accountability. I will talk about the DII a little bit more at the end of this presentation.

To go on, then, in 1986 we had a stiffening of the 1962 statute, the Truth in Negotiations Act.[9] The Truth in Negotiations Act that passed in 1962 was simply a disclosure statute. It was never envisioned to be the predicate for fraud prosecution, but it grew into that later on. The whole idea was, "Look, if we are a defense buyer and you are a defense seller, let's display what your costs are so that we have a more level playing field in negotiating estimated costs or negotiating price, if we are talking about a price." That was stiffened, then, in 1986, and gradually became a strong predicate for prosecuting companies who in submitting their cost or pricing data knowingly provided false information, a very strong and fertile area for prosecution.

The DOD Voluntary Disclosure Program was established in 1986, which in its heyday was a very successful program. The Voluntary Disclosure Program is faltering today. It is not used to the extent it was before. I personally blame not the lack of interest of the DOD, nor the lack of interest of the contractors. I blame the plaintiff's bar because, unfortunately, if a company makes a voluntary disclosure, that information likely is not likely confidential; it becomes part of the public record. Not only does the company which has made a voluntary disclosure have to own up to the Defense Department and DOJ in making them whole regarding the consequences of the fraud revealed in the disclosure, but it also provides a road map for third party lawsuits by plaintiff's counsel. There is no sure protection of any of the information that is disclosed.

The U.S. Sentencing Commission is pursuing a notion—I am not sure how far it will get—but is pursuing a notion of some sort of self-evaluative privilege such that if a company receives a report of fraud, conducts an internal investigation, and takes that internal investigation to the Defense Department, for example, under the Voluntary Disclosure Program, as a self-disclosure, this self-evaluative privilege would protect that information from use other than the official use by the government. I do not know

9. 10 U.S.C. § 2306a (1982 & Supp. IV 1986).

whether it will get there, but at least it would protect companies from all these abusive lawsuits from the plaintiff's bar.

We also had major revisions to the Civil False Claims Act in 1986.[10] Of course, this is a Lincoln-era law. It was substantially stiffened in 1986 as a result of many people, including John Phillips, who is now a *qui tam* lawyer par excellence. John is a good friend of the JAG School. He has spoken here many times. In fact, John was a former Creekmore lecturer. John spent the better part of about ten years before 1986 lobbying Congress, in particular Senator Grassley, to get these amendments through so that the proof required was made easier and the *qui tam* plaintiff would enjoy a greater percentage of recovery. John Phillips wanted a more formal mechanism for those lawsuits to be put under seal and evaluated and reviewed by the Department of Justice. Justice then would make a determination whether to go forward or let the complainant go forward on its own. It was a major event, and it is a very big business today for people who are in that area. There are a number of law firms in the country that do that.

The Program Fraud Civil Remedies Act became law in 1986, as did the Anti-Kickback Act.[11] Now here is an interesting thing. We have always had specific and explicit protections from giving bribes and gratuities from the prime to the government. That has been with us for a long period of time. What the Anti-Kickback Act has done is take it down another level so that it is illegal to provide anything of value to a prime or to a higher-level subcontractor in exchange for some favorable consideration. That favorable consideration usually is one of two things: (1) either the award of the work; that is, you get the subcontract or an order; or (2) and probably more dangerous, a relaxation of the inspection and vendor quality assurance that comes in. The latter results in substantially less protection for the government when a kickback has been paid.

The law presumes that the value of the kickback is built into the price to the government, so the government is able to go after the miscreants under that statute. The law also places a very heavy obligation on prime contractors and first-tier subcontractors to have a formal program to prevent kickbacks. All the major ones do have a very formal program, which includes training, periodic reviews of contract files, and surprise inspections. Some of them even rotate their buyers from time to time so that they

10. 31 U.S.C. §§ 3729-3733.
11. 41 U.S.C. §§ 51-58 (1982 & Supp. IV 1986).

do not get too cozy with a particular vendor. It has been a major statute in fighting defense contract fraud, and one that I think has put us in good stead.

A number of companies, very good companies, have been prosecuted under the Anti-Kickback Statute because they were unaware that their buyers were actually accepting kickbacks. A couple of very major New England companies recently were in that situation; they were surprised; they had absolutely no idea. Whether they should have known is another issue. Whether they had reason to know is another issue, but they did not know that these practices were going on. Sometimes the kickback is a very subtle thing like, "Hey, how about giving my kid a job when he's home from college next summer." That has happened in exchange for some implicit or explicit favorable consideration. We had a case once where the value given was constructing a porch and putting a roof on a vacation home of one of the buyers. Those things were discovered, and they were prosecuted. Between 1985 and 1987, thirty-five contractors—that is only a two-year period—were convicted of defense procurement fraud.

I do not know how many of you have seen the DOD IG contract fraud handbooks. They are useful. The first one was put out in March 1987 to alert auditors on how to detect fraud in defective-pricing cases. I have also seen other publications on labor mischarging, on material substitution, and other species of defense fraud. Very valuable guidebooks not only to auditors, but also to investigators.

In November 1987, the Sentencing Commission Guidelines for Individuals finally went into effect. This removed substantial discretion from the trial judge and jury. To a large extent, it made the determination of a sentence of an individual based on a computation of pluses and minuses.

The 1988 Procurement Integrity Act,[12] which dealt principally with revolving door issues and protecting valuable procurement information, was directly traceable to the abuses revealed by Operation Ill Wind. The "revolving door" was a very common situation, as was stealing and using relevant procurement information. A few years ago, there was a big competition between XYZ Ironworks and ABC Corp.. It was a Navy procurement. One day when the Navy delegation left the building of the XYZ Ironworks, it left behind the pricing information of ABC Corp. on the conference room table. Some say the Navy left the information deli-

12. *Id.* § 423 (1988).

berately because they really wanted XYZ Ironworks to win the contract; some say inadvertently—they were just sloppy and left it there. In any event, this precious, valuable competition information was left.

When it was found by the XYZ Ironworks employee, the first thing he did was to take it to the CFO, Chief Financial Officer, who made a copy of it and then passed it on to the CEO. The CEO took it and read it, kept it for a couple of days, and then consulted with his general counsel. The lawyer said, "You have to give it back. You have to give it back, and you have to tell the Navy exactly what happened here and disqualify yourselves from the competition." Well, at first they did not want to do that. The CFO did not want to do that; the CEO did not want to do that. The Navy did find out about it. The Navy was, of course, more than mildly upset. The Navy then disqualified Ironworks from the competition. They also suggested that both the CEO and the CFO be fired, and they were. And guess what happened? As I recall, the general counsel became the CEO. Yes!

Finding procurement information happens every once in a while, and almost all of the defense industry contractors now have a process for implementation when visiting government folks inadvertently leave precious procurement information behind. All the big aerospace and defense companies now have a procedure such that when information is found, it is delivered to a person called the take-out officer. The take-out officer in coordination with the general counsel informs the agency, conducts an investigation to see who has knowledge of that information in the acquisition process and disqualifies them from any participation in the competitive process. So not only do we have the Procurement Integrity Act, but we also have a stiffening of internal controls to deal with this.

The revolving door notion, however, has been ignored lately. Almost all of our major defense acquisition executives come from industry, and they are going to go back to industry. There are not any real safeguards. We have to depend on the integrity of the individual. There is this free personal exchange back and forth. Government engineers who really understand the engineering of our major weapons systems leave and go to industry, taking all of that knowledge with them. I am not saying there is anything wrong with that, but I do think it presents some new revolving door issues that we simply have not paid enough attention to lately.

The major fraud act of 1988: the Drug-Free Workplace Act.[13] This is almost a joke, isn't it? It had aspects of keeping the workforce pure, of

rational mind, and efficient; but it really has not done much at all. A number of companies do random testing, and they all have programs, educational programs and so on, but I do not think it has done a whole lot.

In 1989, the DOD IG obtained more funding and staffing. *Qui tam* began to catch on. It was big-time business then, and it is even bigger now. The President also signed the Whistle-Blower Protection Act[14] in 1989 to give some courage to the whistle-blower. It does take courage to blow the whistle on your company. The *Wall Street Journal* last week had an article about a guy who was a whistle-blower in his company. He then voluntarily left the company. It was more than a year ago, and he still can't even get a job interview in the industry. He is an anathema because of what he did; he is regarded not as a hero and a whistle-blower, but a snitch and somebody not to be trusted. So we have a long way to go in that area, too, to encourage whistle-blowers. Sarbanes-Oxley[15] has taken a step in that direction, but we have a long way to go.

The Alternate Dispute Resolution (ADR) Act of 1990[16]—did you know that ADR is used in fraud cases? It is. There are circumstances in which contractors have settled factual issues through an ADR process even though it happens to be a fraud case. Far and away the biggest problem during 1990 was in cost mischarging—forty-six percent of cases—and product substitution—twenty-six percent.

In 1991, the *Wall Street Journal* published a story that many states were providing incentives to companies that adopted compliance programs. How about that? Finally, we were getting a little more emphasis on the carrot as opposed to the stick. From 1982 to 1991, it has been the stick, the stick, the stick. Now we were getting a little emphasis on the carrot—in charging decisions made by the U.S. Attorney's office and in sentencing decisions—to give some incentive to companies to try to do the right thing.

We also enacted 10 U.S.C. § 2408, which is a very effective statute. It means if you are convicted of fraud in connection with a defense contract, you cannot really hold a job, any responsible job, that is, working on defense contracts for at least five years following that conviction. That

13. *Id.* §§ 701-707.

14. Pub. L. No. 101-12, 103 Stat. 16 (1989) (codified in scattered sections of 5 U.S.C.).

15. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

16. 5 U.S.C. §§ 571-583.

statute is very rigorously enforced to my knowledge, not by the Army, but by the U.S. Attorneys for the region in which the company is located.

November 1991 saw another opportunity to offer more of the carrot when the corporate sentencing guidelines went into effect. Also, the Environmental Protection Agency (EPA) published guidelines stating the compliance elements to be considered in debarment. The EPA has taken a very strong view, at least since 1991, when it comes to escaping a suspension or debarment by the EPA. You have to show more than just correction of the conditions that led to the Clean Air Act problem or the Clean Water Act problem. You have to prove that you have the right corporate attitude—they use that term, the "right corporate attitude"—and demonstrate that attitude to the EPA debarring official, or you are not going to avoid a suspension or debarment.

The sentencing guidelines established in November 1991—for a corporation or an organization to reduce a corporate fine—parallel what the DII did in 1986, with one major difference. The sentencing guidelines speak to *compliance*. The DII guidelines, however, speak to *ethics*. It is the DII on Business Ethics and Conduct, not business compliance and conduct. The mindset of the DII companies is that compliance is the absolute minimum. It is presumed that you are going to comply with the law and the regulations. Over and above that is this commitment to ethics such that you do the right thing when there is no rule.

In 1992, the Ethics Officers Association was established. This association is across the board, not DOD only. It is across all industries, civilian and military related. Today it has about 800 individuals, with its center of gravity at Bentley College in Boston, Massachusetts. It meets two or three times a year with formal programs that address ethics issues. These meetings are a wonderful learning opportunity to see what is going on in the commercial world in the way of embracing and practicing ethical conduct. Believe me, the practice of good self-governance is catching on.

In May 1994, the DOD concluded an administrative compliance agreement with Lucas Aerospace. To my knowledge, that was the first real formal agreement that permitted a company to avoid suspension and to avoid debarment. We have had agreements before that, but they were not expressed in detail and did not include the discipline and the safeguards and controls as did the one in Lucas. This was a Navy agreement. Lucas was alleged to have ripped off the Navy on some components to some model aircraft parts, and they avoided debarment by entering into this

administrative compliance agreement. Many such compliance agreements have followed. The Army sometimes is willing to do that, as is the Navy and the Air Force. David Drabkin, the GSA debarring official, a registrant, is not here at this moment, so I will testify that he will not do it. I have never known Mr. Drabkin to enter into a compliance agreement as the GSA debarring official. Maybe someday he will; who knows?

To go on, then, we had this *Caremark* decision in 1996.[17] I am sure all of you are very much aware of that. This was the decision of the Delaware court that specifically requires directors to take an active role in establishing and overseeing a compliance program within the company at peril to personal liability, a landmark case in this area. If you are not familiar with that case, pull it out and take a look at it because it has made a terrific difference in publicly traded corporations. They take the exposure to personal liability very seriously, as do their insurance companies, so it has made a big difference.

Then we had the series of cases in 1998 in which the Supreme Court held that in certain circumstances, if the company had a good compliance program, it might shield the company from liability for an employee's sexual harassment. Again, if you can show that you are trying to do the right thing, that you have the right policies, training, rules, supervision, and due diligence, and it still happens, then at least the company might dodge the bullet.

In June 1999, Eric Holder, who was then the Deputy Attorney General of the United States and a former U.S. Attorney for the District of Columbia, put together a beautiful letter and memorandum which is a guideline for federal prosecutors in determining whether to charge corporations.[18] It is a landmark piece of work. It, again, gives recognition to companies that try to practice self-governance and try to do the right thing.

More recently, we have had Sarbanes-Oxley.[19] I am not going to spend a lot of time on that because it is not specifically a defense contract fraud statute. It applies to all companies regulated by the Securities and Exchange Commission; all issuers, if you will, all publicly traded U.S.

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17. *In re* Caremark Int'l, 698 A.2d 959 (Del. Ch. 1996).

18. Memorandum from Eric J. Holder, Deputy Attorney General, to Heads of Department Components All United States Attorneys, subject: Bringing Criminal Charges Against Corporations (June 16, 1999) (with attachment entitled *Federal Prosecution of Corporations*), *available at* http://www.usdoj.gov/04foia/readingrooms/6161999.htm.

19. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745.

companies, so it would include most defense companies, and many, many others as well. Some of the anti-fraud features in Sarbanes-Oxley, which are being implemented as we speak, involve protection of whistle-blowers, conflicts of interest, stiffer corporate governance, and a code of ethics. Certifications are back. We tried to get away from that in DOD, but they are back under Sarbanes-Oxley.

So now CEOs and CFOs have to do what? Certify. Covered companies have to file these financial reports quarterly and annually. Previously, this certification merely said that it "applied to a good accounting standard," or something like that. Now they have to say more than that, that it "fairly represents the financial condition of the company." That is a big one to put your name on, fairly represents the financial condition of the company. The first wave of those certificates went in earlier this year, and I think we will see that result in more attention to good corporate governance.

In response to the document shredding incident last year of Arthur Andersen, Sarbanes-Oxley also expands the criminal provisions that govern obstruction of justice. That is what Andersen was convicted of. It was not convicted of anything else but obstruction, and the form of obstruction was the shredding of documents done in Enron's office in Houston.

Just a little bit more about the DII. If you are not familiar with the DII, I encourage you to become familiar with it.[20] One of the important things that the DII does: it holds a "best practices" meeting every May with a substantial number of representatives of the Defense Department, the debarring officials, the IGs, the DCIS, and the procurement policy people. We meet for a day and a half in Washington, D.C., to share best practices on good corporate governance and going after government contract fraud. It is a very rich experience for both government and industry representatives. We willingly share best practices with each other and openly disclose what is going on. There are no secrets from the Defense Department customer about what we are doing by way of corporate self-governance. We may have a lot of other business secrets, but we share in this effort of good corporate governance. I am a strong proponent of the DII.

DII's organization is informal. The steering committee, which is like the board of directors, consists of thirteen top corporate executives. Our

20. For more information on the DII, see its Web site, http://dii.org. The DII principles that guide its signatory companies are displayed on the Web site.

chairman is Vance Coffman, the chairman and CEO of Lockheed Martin Corporation. Some of the other representatives come from household names in the defense industry, like Honeywell, Boeing, Raytheon, Textron, UTC, Harris, Northrop Grumman, Rockwell Collins, and so on. We last met with the DII steering committee in November in Phoenix, Arizona, in connection with the annual Aeronautic Industry Association meeting. Because of the crowded agenda, they set aside the time for the DII meeting to begin at 6:30 in the morning. I will tell you—this is the gospel truth—every single one of those CEOs showed up, thus reflecting their commitment to what the DII is all about, and to give us their guidance, their leadership, and our charter for work for the next year. One of the things they want the DII to do, and they are dead serious about it, is to try to export what the DII's doing down to the next tier, to major subcontractors. To encourage major subcontractors to embrace and practice good corporate self-governance just as the DII has been doing. That was a very telling meeting.

In conclusion, I do think that the defense industry has come a long way since twenty years ago. I hope you agree. It was the terrible fraud and abuse situation that twenty years ago engendered what was "in the best of times" and the "worst of times." The defense industry has come a long way in pulling ourselves out of that. I think I have illustrated to you that one of the key developments in the defense industry is the emphasis now on ethics and self-governance to encourage corporations to do more on their own, to practice self-governance on their own, and to reduce the requirement for oversight by auditors and inspectors and prosecutors.

I also think that this litany of laws that I have gone through with you, alone, is not going to solve procurement fraud. Quite frankly, I believe that these laws have abated contract fraud in the defense industry to a substantial degree. Have we stamped it out? Absolutely not. We still have more to do, but I do think that we have done about as much as we can do with the statutes, the regulation, and the punishment. What we need to do now is to emphasize the "carrot" to stimulate industry to do more on its own through a culture of ethics. My belief is that ethics trumps the effectiveness of penal laws and enforcement.

Well, it has been a real joy. I appreciate the warm welcome I received. I enjoyed the reception last night. I am deeply honored to be your Creekmore lecturer, and I hope I have added a dimension to your understanding of where we are and how we got here over the last twenty years. Thank you.