



National Association of Aircraft & Communication Suppliers, Inc.

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## CASE STUDIES OF GOVERNMENT CONTRACT & EXPORT FRAUD

### EXECUTIVE SUMMARY

The following case summaries were collected from various sources, including records from actual suspension and debarment proceedings initiated by the Defense Logistics Agency ("DLA"). These case summaries were prepared to provide you, the members of the National Association of Aircraft & Communication Suppliers ("NAAACS"), with examples and scenarios of how and when small companies that contract with the government and export regulated goods such as military surplus can get themselves into serious trouble that may result in debarment or suspension, criminal prosecution, severe penalties and/or significant monetary fines.

Small government contractors are particularly vulnerable to suspension and debarment proceedings. In fact, suspension and debarment proceedings are almost always brought against small government contractors as evidenced by the General Service Administration's List of Parties Excluded from Federal Procurement and Nonprocurement Programs. Large companies such as Boeing and Northrop Grumman, not only have the resources to negotiate alternatives to suspension and debar-

ment, but also are usually exclusively relied on by the government to provide certain military equipment and technology and therefore are almost never suspended or debarred.<sup>1</sup> Thus, for small government contractors, it is imperative to be proactive in your efforts to comply with federal regulations and laws.

You will notice that some of the case scenarios were taken from actual suspension and debarment proceedings initiated by DLA. As you review these cases, it will be helpful for you to understand the exact meaning of the terms "suspension" and "debarment." In procurement law, suspended and debarred contractors are excluded from receiving government contracts. Federal Acquisition Regulation (FAR) 9.405 (a). When a company is suspended, they are temporarily disqualified from contracting with the government pending the completion of an investigation or legal proceeding. FAR 9.407. However, if legal proceedings are not initiated within 12 months of a suspension, the suspension must be terminated. Debarment occurs when, in the government's interest, a company is completely disqualified from doing business with the government for a

"reasonable, specified period." FAR 9.406-1 and 9.406-4.

Government agencies, such as DLA, are responsible for initiating the suspension and debarment proceedings. If a government contractor is criminally indicted or civilly sued for contract fraud, the government may "suspend" the contractor from further contracting with the government, pending the outcome of the criminal or civil trial. If, the contractor is found not guilty in the case, then the government will drop the suspension. If, however, the contractor is found guilty (and is sentenced to prison or pays a fine), the government will likely convert the suspension into a debarment.

Criminal and civil proceedings and the suspension and debarment proceedings are two separate enforcement actions. Under criminal law you may be imprisoned or be fined (and if prosecuted civilly you may be fined). Such penalties do not occur under debarment or suspension proceedings. A suspension or debarment means that you are banned from doing business with the government (i.e. buying from or selling

<sup>1</sup>In the summer of 2003, three divisions within Boeing were suspended by the Air Force for illegally obtaining proprietary information, however, the non-suspended divisions within Boeing continued to receive government contract awards despite the suspension of the three divisions.

to the government). Judges and juries decide liability or guilt in civil and criminal cases, whereas suspension and debarment matters are administrative in nature and are decided by government employees.

According to DLA attorneys, falsifying documents is one of the most common reasons why small businesses are prosecuted criminally and subsequently debarred or suspended. The case scenarios you will find below are the result of the following types of falsification:

- Falsifying government required tests and test results
- Falsifying "cure dates"
- Falsifying certifications of conformance and other required certifications of merchandise
- Inflating and falsifying bills

Usually companies will falsify documents in order to misrepresent the fact that required quality controls and other specifications were met, when in fact such requirements were not met. The result of this type of falsification is criminal prosecution and subsequent suspension or debarment from government contracting.

Violating the export regulations found in the International Trade in Arms Regulation ("ITAR") and violating the False Claims Act ("FCA") are other reasons why businesses can be held liable for fines, penalties, large amounts of civil damages and may face criminal prosecution. The consequences of the following types of violations can be devastating for a business:

- Exporting and releasing restricted merchandise and technology without receiving the necessary approval and/or export license from the government
- Illegally exporting to "front" companies
- Failing to seek a State Department determination of whether merchandise was commercial or military
- Falsifying qualifications for the Small Business Administration's 8(a) program
- Inflating costs
- Selling defective parts

Please do not hesitate to contact us if you have questions regarding the following case summaries.

## CASE SUMMARIES

DLA has initiated suspension and debarment proceedings against various companies for the following situations. The criminal charges were brought prior to the suspension or debarment proceedings.

- A company was criminally charged with conspiracy to defraud the government and to submit false claims arising out of the falsification of test results for Residual Gas Analysis ("RGA"). Military standards require that micro-electric circuits be RGA tested to determine the presence of moisture because excessive moisture leads to corrosion. The company was charged with falsifying the RGA tests and concealing defective testing procedures. The company and its owners and employees were found guilty of the criminal charges at the conclusion of a jury trial. The company was sentenced on four counts of submitting false statements to the government, eleven counts of aiding and abetting false statements and eleven counts of making false claims for payment. Subsequently, DLA initiated debarment proceedings and debarred the company and its principals for a period of three years. The debarment applied to procurement, non-procurement and sales contracting with the government.

- Two companies, one a wholesale distributor of aircraft parts ("Company A"), the other an aircraft parts and supplies wholesale distributor ("Company B"), were suspended by DLA. The President of Company A owned 100% of the capital stock of both Company A and B. Both companies were criminally charged with conspiracy, false claims, false statements, mail fraud and aiding and abetting. Additionally, the Federal Aviation Administration ("FAA") conducted an audit of Company A. The charges were brought because the quality control manager of Company A issued false work orders and identification tags that misrepresented the "cure date" of certain rubber hoses. The cure dates of rubber hoses are required because rubber hoses can deteriorate. The cure date acts as a quality control measure. The manager was alleged to have instructed an employee to change the cure date to a newer cure date. After the audits and investigations, Company A undertook several corrective actions such as adding a signature to the work order form to ensure accountability, banned unsigned changes to work orders, issued Business Conduct Guidelines tailored to the business and informed employees that failure to adhere to the guidelines would result in disciplinary

action. Company A was suspended. Because the President of Company A owned 100% of the capital stock in Company B, the suspension was imputed to Company B and thus both companies were suspended. Nine months later, Company A pled guilty to the criminal charges and, based upon the corrective action that was taken, DLA lifted the suspension of both companies.

- Suspension proceedings were initiated by DLA against a company for mail fraud.<sup>2</sup> The company, a wholesaler of aircraft parts, supplied and distributed fasteners to the government and commercial entities. The company purchased ordinary commercial fasteners with no evidence that the fasteners met government specifications, but then sold the fasteners as government specification parts. False certificates were provided to customers which stated that the products were in conformance with current applicable specifications when in fact some of the parts that were sold came from commercial untraceable stock inventory and failed to meet the applicable specifications. The company and all its affiliates were debarred by DLA. The company's criminal conduct was uncovered by the government as a result of an undercover operation run by the Defense Criminal Investigative Service ("DCIS") and the FBI.
- Inflating a bill for services rendered to the government can also lead to criminal prosecution and suspension or debarment. In one instance, an individual instructed a consultant to inflate a bill for services provided to the government. The criminal conduct of the individual was imputed to the company because the individual's conduct occurred in connection with the performance of duties for the company or at least with the company's knowledge, approval or acquiescence. A company "affiliated" with that particular individual had debarment proceedings initiated against it.<sup>3</sup>
- Criminal charges and debarment proceedings were brought against a company that manufactures and sells aircraft parts because the company falsified Certificates of Conformance ("COCs"). The COCs falsely certified that the parts were manufactured, inspected and tested under a military authorized inspection system (MIL-I-45208A). However, subsequent testing by a qualified testing center determined that the items could not have been properly tested. The company was criminally prosecuted and then subsequently debarred by DLA.

**Below are more situations where companies have been sued for millions of dollars and/or criminally prosecuted.**

- An aircraft surplus dealer, who purchased surplus parts from the Defense Reutilization and Marketing Service ("DRMS"), was criminally prosecuted and found guilty in Federal court for violating the ITAR. The dealer illegally exported munition list items to China. A joint investigation by DLA'S Defense Criminal Investigations Activity and U.S. Customs revealed that the parts were for F-117 and F-111 aircraft.
- Raytheon Co. ("Raytheon") faced a civil complaint brought by the Justice Department alleging that the company violated export rules when it failed to seek a State Department determination of whether a radio system was commercial or military. Even though the radio was never actually delivered, Raytheon paid \$25 million to settle the civil case. Under a 1994 contract, Raytheon agreed to sell the radio system to Pakistan. The contract was for a modified version of a radio system designed by Raytheon for the Air Force in the 1970s.
- Five small businesses selling aircraft and missile parts were searched as part of a national investigation relating to alleged illegal sales of aircraft and missile parts to Iran. Thirteen other small businesses were served with search warrants and some individuals associated with the small businesses were served with grand jury subpoenas. The companies were suspected of illegally exporting items listed on the U.S. Munitions List without obtaining the necessary licenses from the State Department. The items at issue were components for HAWK missiles, F-14 Tomcat fighter jets, F-4 Phantom fighter jets, F-5 fighter jets, C-130 Hercules aircraft, military radars and other types of equipment. It was alleged that the components were sent to a "front" company called Multicore Ltd. ("Multicore"), also known as AKS Industries that had offices in Bakersfield, California and London. The Multicore office in London was run by Soroosh Homayouni and the California office was an apartment rented by Saeed Homayouni, Soroosh's brother. The brothers were criminally convicted for shipping the components to Iran via Singapore. Investigators said that the seized records of the small businesses could result in other individuals being prosecuted by the U.S. Attorney's Office for additional criminal offenses (to date, that does

<sup>2</sup>Note that any document that is faxed to the government may come under a mail fraud violation. For example, if a person falsifies a document and then faxes that document to a contracting officer, then that person has committed mail fraud.

<sup>3</sup>An individual can be an "affiliate" if s/he controls or has the power to control the company.

not seem to have occurred).

- The Boeing Company (“Boeing”) and Hughes Electronics Corp. were both charged with 123 violations of the Arms Export Control Act (“AECA”) and the ITAR for illegally transferring space-related technology including technical assistance to China, which China could use to enhance its military capability. As a result both companies faced \$500,000 fine per violation and the denial of export licenses. Boeing eventually paid \$32 million to settle the charges that it transferred technology to China.
- Condor Systems Inc. (“Condor”) was sentenced to three years of probation and fined \$1 million and found guilty of felony charges for making false statements to government officials. Condor illegally released technology and other information to Sweden when it had an agreement with the Navy not to release the technical information without the Navy’s approval.
- A construction contractor falsified that he was of Native American ancestry in order to participate in the Small Business Association’s (“SBA”) 8(a) program. The contractor also falsified that he had no prior criminal record. The construction company, after receiving the 8(a) eligibility, was awarded approximately \$17 million in U.S. government contracts. The contractor and his company were required to pay a \$78,000 fine and \$172,000 in restitution. Additionally, the contractor and his company were permanently debarred from any participation in the SBA certification program.

- Sigma-Aldrich Corp. (“Sigma-Aldrich”) and two of its subsidiaries paid \$1.76 million in fines to settle charges that involved the illegal export of biological toxins. The fine is one of the largest penalties ever paid to the Commerce Department for violating U.S. export regulations. The case stands for the proposition that companies can be held liable for the actions of other companies that it acquires. Sigma-Aldrich failed to discover the prior unlicensed exports and allowed the illegal exports to continue for one year after acquiring the company in violation of export laws.
- Lockheed Martin Corp. (“Lockheed Martin”) paid \$37.9 million to settle a suit under the False Claims Act (“FCA”).<sup>4</sup> The company settled allegations that it inflated costs for several contracts with the Air Force. A former employee of Lockheed Martin initiated the suit. The suit accused Lockheed Martin of inflating cost proposals for four foreign military sales contracts for the purchase of navigation and targeting pods for military jets. The inflated cost proposals allowed Lockheed Martin to compensate for overruns on other contracts with the Air Force.
- Northrop Grumman paid the government \$20 million to settle a suit alleging that the company sold the Navy unmanned aerial vehicles (or target drones) that contained defective parts. The government claimed that the vehicles experienced significant operational failures due to the defective parts. Northrop Grumman denied liability and settled the case so that the company could focus on current and future business operations.

<sup>4</sup>The False Claims Act allows for whistleblower (“qui tam”) actions where a private individual may bring a suit on behalf of the government alleging that the government has been defrauded. Usually employees of the company will “blow the whistle” on companies that defraud the government. If the suit is successful, the party committing the fraud is exposed to civil liability in an amount equal to three times the monetary amount of the fraud. Employees have a financial incentive to blow the whistle because they may recover for themselves up to one-third of the amount recovered by the government in the case.

## JOINING THE NAACS

The NAACS is an organization of approximately 120 small businesses representing a broad spectrum of the aviation community. NAACS members include: (a) spare parts distributors who supply aircraft and electronic parts to the U.S. and friendly foreign military services; (b) operators who use military surplus aircraft in industrial and commercial lifting operations and logging; (c) aviation repair stations and facilities who install military surplus parts; and (d) companies approved by the Department of Defense (“DOD”) and the FAA to manufacture

parts for installation in military and commercial aircraft. The common trait shared by our members is that they rely on military surplus aircraft parts. Many of them routinely purchase military surplus parts directly from DOD’s Defense Reutilization and Marketing Service and its private contractor Government Liquidation. For Membership Information, Contact Ed Wilk, Membership Chair at (210) 924-5561 (phone), (210) 924-4901 (fax) or John J. Fausti, Executive Director at (202) 237-0505 (phone) or (202) 237-7566 (fax) or by e-mail at [jfausti@faustilaw.com](mailto:jfausti@faustilaw.com)

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