



NATIONAL SCIENCE FOUNDATION
OFFICE OF INSPECTOR GENERAL
OFFICE OF INVESTIGATIONS

CLOSEOUT MEMORANDUM

Case Number: I97050020

Page 1 of 1

In May 1997, we received notice that the Attorney General was served on April 17, 1997, with the complaint filed in the United States District Court, Southern District of _____, under the qui tam provisions of the False Claims Act in the matter U.S.

The complaint alleged that _____ conspired to file false claims for labor charges against contracts from the Department of Defense (DoD) and Department of Energy (DOE), and a cooperative agreement from NSF. We joined an existing investigation led by the Department of Justice and assisted by Special Agents from DoD and DOE.

Following a bench trial beginning on March 25, 2003, and concluding on April 10, 2003, on June 12, 2003, the court found in favor of _____s and against the government on all claims; a copy of that decision is attached.

Accordingly, this case is closed.

2002N00936

FILED

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CLERK U.S. DISTRICT COURT
SOUTHERN DISTRICT

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UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF

UNITED STATES OF AMERICA ex rel.

CASE NO.

Plaintiff,

STATEMENT OF DECISION
(FED.R.CIV.P. 52)

vs.

Defendant.

This action, brought under the False Claims Act, 31 U.S.C. §§ 3729, *et seq.*, was submitted to the court for decision after a bench trial beginning on March 25, 2003 and concluding on April 10, 2003. The matter was later formally taken under submission after the parties supplemented the evidentiary record with exhibits and deposition testimony excerpts.

The court, after careful consideration of all the evidence, pleadings and arguments of the parties, and for good cause, renders its decision in this matter.

BACKGROUND

The government and *qui tam* relator have brought this action against defendant, essentially claiming that for several years in the 1990's defendant claimed and received payment for unallowable and inflated costs for work performed by

This claim by the government is primarily predicated on the contentions that defendant was affiliated with and under the common control of () and that, therefore, it was in

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1 violation of the False Claims Act for "pass through" the profits of , well as its own
2 profits when billed the government on its cost plus fixed fee contracts. Although , does not
3 dispute it passed through the profits of when it billed the government on its own contracts,
4 has steadfastly denied that was under its control.

5 It is undisputed that since 1957 when formed has been a substantial
6 defense contractor for the government, performing important research in related fields and
7 affiliated projects. In 1987, subsidiary of
8 which was in turn a subsidiary of Corporation , was acquired by .

9 During the time from July 1992 through December 1997, contracted with to
10 perform work on numerous contracts it maintained with such agencies as the National Science
11 Foundation ("NSF"), the Department of Energy ("DOE") and the Department of Defense ("DOD").
12 Those contracts, issued on a cost plus fixed fee or cost-reimbursement basis, required to comply
13 with numerous regulatory provisions, including the Office of Management and Budget Circular A-110
14 ("Circular A-110") and the Federal Acquisition Regulations ("FAR").

15 Even before the 1992-1997 period during which retained the services of had
16 employed the concept of utilizing job shop or temporary labor providers. Specifically, during the
17 1990-1992 time period utilized temporary labor supplied by
18 joint venture partner of which was largely managed by a
19 employee from 1975 until the time she became "seconded" to in 1990. When dissolved
20 in 1992, it was the decision of to continue utilizing temporary labor providers where possible,
21 largely to avoid the responsibility of accounting for the employees as their own, but also to meet the
22 demands of flexible staffing needs.

23 At the time of 's dissolution, proposed the creation of a new staffing
24 company, to and the sons of Neither nor
25 was a substantial shareholder of , nor did either of them hold a position of manager, director,
26 or employee of

27
28 A seconded employee is one who is released from regular employment to take employment with
a second company. The employee is, however, retained as an employee of the first company only for
accounting purposes.

1 Based upon the presentation made by / to / and /, it was agreed
2 / would be formed. Upon incorporation of /, 1992, / and / each
3 paid \$1,000 for all the company's stock. A start-up loan of \$150,000 was secured by
4 from /, with / and / securing the loan
5 with their personal guarantees. / was affiliated with / and / and
6 / agreed that although / and / were the only shareholders and directors
7 of /, / would essentially operate and manage / its president and CEO,
8 and would receive 20 percent of the profits. / managed all aspects of / affairs
9 (e.g., daily operation, fiscal matters, employment decisions) while keeping / and /
10 informed of significant developments. During the time period in question, / was an
11 employee of /, seconded to / with no duties or responsibilities to /
12 At the prospect of / taking over the responsibility of supplying temporary labor services
13 from / upon its dissolution in 1992, /, Senior Vice President, Finance, and Chief
14 Financial Officer of /, asked /, Comptroller of /, to investigate the question of
15 whether /'s issuance of a purchase order to / for temporary labor services would violate the
16 "common control" proscription of the FAR regulations.³ In response to the request of Mr.
17 Mr. / carefully reviewed the relevant factors concerning common control with
18 /, Director of Government Accounting. These factors included common ownership,
19 common management, common facilities, and contractual relationships. Thereafter, Mr.
20 informed auditors of the Defense Contract Audit Agency ("DCAA") of /'s conclusions of lack of
21 common control.⁴ The analysis and conclusion of / drew heavily upon communications between
22 / and DOE auditing/contracting representatives on the earlier and separate question of whether

23
24 ² E.g., / held executive positions with both / and /

25 ³ The FAR regulation (FAR section 31.205-26(e)) limits profits on sales between "divisions,
subdivisions or affiliates" under the common control of a contractor.

26 ⁴ / apparently did not believe it was necessary to advise DOE auditors as well because
27 "interface" on such matters had historically been with DCAA.

28 ⁵ / did not use the "identity of interest" test of FAR 19.101.

1 and its realty companies (leasing land and facilities to were under common control. Although
2 the DCAA concluded that and the realty companies were subject to common control in 1992, that
3 conclusion was short lived as both before and after 1992 the DCAA concluded that common control
4 did not exist between and its realty companies. The DCAA's inconsistent conclusions over a
5 period of several years was attributable, in part, to different analysts and attorneys being assigned to
6 the realty companies case by the DCAA. Suffice it to say that the inconsistent and fluid decision-
7 making of the DCAA on the realty case provided limited guidance to the time it was considering
8 its options with in 1992.

9 Meanwhile, Mr. concluded that and were not under common control,
10 communicated that conclusion to his superiors, and, in July 1992, the Human Resources Department
11 of directed its Purchasing Department to issue a blanket purchase order for temporary labor
12 services to . Thereafter, and still in July 1992, and entered into an agreement
13 by which it was to bill for services rendered on the purchase order issued to
14 then advised employees, still available upon the dissolution of , that
15 would from that point forward provide job shop services to in effect, as successor in interest to
16 .

17 Mr. , a buyer with Purchasing Department, was given the task to place the
18 purchase order with . At the time, Mr. was taking direction from of senior
19 management to "expedite" the procurement in the form of the purchase order for \$5.4 million.
20 Mr. , having no knowledge as to the experience of providing job shop services, was
21 receiving considerable pressure to issue the order on a sole source basis upon the rationale that
22 competitors had only limited personnel pools. Mr. , operating under the constraints
23 above, utilized a competitive rate analysis done in 1990 in connection with retention of s
24 services, and justified the purchase order on that basis. The purchase order to for temporary
25 .

26 "The court is aware that after Mr. reached his conclusion, a July 2, 1992 memorandum
27 from to Job Shop Coordinator, requested Ms. to issue a
28 purchase order to . Although this correspondence would appear to blur the lines between
and for job shop purposes, the weight of the evidence indicates reached its own conclusion
and directives regarding job shop services from and that the memorandum of
was ill-conceived and of no consequence.

1 labor services was extended over several years and grew in scale from \$5.4 million to over \$17
2 million.

3 Approximately one year later, in 1993, Mr. [redacted] based on a recommendation from /
4 [redacted] considered outsourcing the janitorial services for [redacted] to [redacted]. A cost analysis was done,
5 and Mr. [redacted] decided to award the order for janitorial services to [redacted]. Ultimately, a purchase
6 order was issued [redacted] by Mr. [redacted] the direction of Mr. [redacted]. Supporting documentation,
7 consisting of a summary procurement memorandum, was prepared by Mr. [redacted] and approved by
8 [redacted], Purchasing Manager for [redacted] at the time. At the time of the issuance of the janitorial
9 purchase order to [redacted] Mr. [redacted] once again reviewed the question of common control and
10 concluded there was none between [redacted] and [redacted], and made necessary disclosures to DCAA on-site
11 auditors that it was issuing the janitorial award to [redacted].

12 In 1996, DCAA conducted an audit of [redacted] purchase orders to [redacted] temporary labor and
13 janitorial services for the purpose of determining allowability and reasonableness of costs under FAR
14 given the information that [redacted] was a "related party."⁷ The DCAA auditor who conducted the
15 audit, [redacted], concluded no common control existed between [redacted] and [redacted] and that costs
16 claimed by [redacted] were proper. The audit also concluded that the janitorial services should be awarded
17 pursuant to competitive bidding. Therefore, DCAA requested [redacted] to obtain competitive bids, not
18 because [redacted] costs were questioned, but because it was a related party.

19 Thereafter, in October 1996, [redacted] solicited competitive bids for janitorial services. [redacted] formed
20 a committee to oversee the bidding process and to review bids received. Mr. [redacted] ultimately
21 reviewed findings and recommendations by the committee and made the decision to retain [redacted]
22 for janitorial services even though its bid was \$100,000 higher than all other bids. Mr. [redacted] based
23 his decision upon his conclusions that [redacted] was as good or better than any bidder and that its
24 employee benefits were superior. Mr. [redacted] was prepared to disallow the entire \$100,000 differential
25 between [redacted] and the next highest bidder and so advised DCAA. Instead, Mr. [redacted] was able to
26 negotiate a \$50,000 reduction from [redacted] and disallow (not charge to the government) the
27 [redacted]

28 ⁷The DCAA was provided all necessary information by [redacted] and was aware that [redacted] son
owned [redacted] and that [redacted] was a seconded employee of [redacted]

1 remaining \$50,000.

2 In a separate DCAA audit following bidding and correction process with respect to
3 janitorial services, the DCAA concluded that the corrective actions undertaken by complied with
4 earlier DCAA recommendations. This brought to a close the auditing process.

5 Clearly, the purchase orders issued by for temporary labor and janitorial services to
6 did not constitute the assignment of government contracts or sub-contracts. Further, these
7 purchase orders did not constitute Government sub-contracts.

8 DISCUSSION

9 The False Claims Act

10 The False Claims Act provides civil liability for any person who:

11 (1) knowingly presents, or causes to be presented to an officer or employee of the United States
12 Government . . . a false or fraudulent claim for payment or approval;

13 (2) knowingly makes, uses or causes to be made or used, a false record or statement to get a
14 false or fraudulent claim paid or approved by the Government;

15 (3) conspires to defraud the Government by getting a false or fraudulent claim allowed or
16 paid

17 31 U.S.C. §3729(a)(1)-(3). In 1986 Congress amended the FCA to define the term "knowingly" to
18 mean a person who, with respect to information, "(1) has actual knowledge of the information; (2) acts
19 in deliberate ignorance of the truth or falsity of the information; or (3) acts in reckless disregard of the
20 truth or falsity of the information." 31 U.S.C. §3729(b).

21 Knowledge, with respect to a corporation, is determined from the aggregate of its employees'
22 knowledge.

23 "[A] corporation cannot plead innocence by asserting that the information obtained by
24 several employees was not acquired by any one individual who then would have
25 comprehended its full import. Rather the corporation is considered to have acquired
26 the collective knowledge of its employees and is held responsible for their failure to
27 act accordingly.

28 United States v. Bank of New England, N.A., 821 F.2d 844, 856 (1st Cir.), cert. denied, 484 U.S. 943
(1987).

Common Control

FAR section 31.205-26(e) limits profits on sales between divisions, subdivisions, subsidiaries

or affiliates" under the common control of a contractor. According to FAR 2.101, "Affiliates" means associated business concerns or individuals if, directly or indirectly, (a) either one controls or can control the other; or (b) a third party controls or can control both." 48 C.F.R. 2.101 (1992-1997). FAR 19.101 also provides guidance on the issue of common control and affiliation. "In determining whether affiliation exists, consideration is given to all appropriate factors including common ownership, common management, and contractual relationships."

(a) Nature of Control. Every business concern is considered as having one or more parties who directly or indirectly control or have the power to control it. Control may be affirmative or negative and it is immaterial whether it is exercised so long as the power to control exists.

(b) Meaning of "party or parties." The term "party" or "parties" includes, but is not limited to, two or more persons with an identity of interest such as members of the same family or persons with common investments in more than one concern. In determining who controls or has the power to control a concern, persons with an identity of interest may be treated as though they were one person.

The preponderance of evidence in this case establishes a lack of common control between [redacted] and [redacted]. It is undisputed that the sole shareholders of [redacted] were [redacted] and [redacted] the sons of [redacted], and that the [redacted] sons held no direct shareholder interest in [redacted] nor did either of the [redacted] sons hold any positions of management, employment or influence with [redacted]. Indeed, the [redacted] sons, although owners of [redacted], were more in the nature of absentee owners of [redacted] ceding management and daily operational decision making to [redacted]. No evidence was adduced at trial that the [redacted] sons exercised any influence over [redacted]'s decision making process, either in connection with the decision to outsource to [redacted] or regarding any other matter. On the other hand, the President and CEO of [redacted], held no ownership interest in [redacted]; nor did [redacted] occupy any official or management position with [redacted]. Although [redacted] attended [redacted] directors' meetings and provided input concerning the decision of [redacted] to outsource temporary labor and janitorial services, Ms. [redacted] did not transform the relationship of [redacted] and [redacted] into one of common control or ownership. Indeed, to the extent the government may contend

"To the extent [redacted] and [redacted] held any shareholder interest in [redacted], such interest arises from their beneficial interest in a family trust which held a minor interest in [redacted]'s parent. Even considering the identity of interest test set forth in FAR section 19.101(2), the [redacted] sons limited and remote beneficial shareholder interest in [redacted] does not weigh heavily in favor of a finding of common control between [redacted] and [redacted]."

1 that controlled steadfast refusal to discount the entire \$100,000
2 differential on the janitorial bidding competition undermines that contention. Moreover, did not
3 share common space with or engage in business in the same industry. Although's
4 financing was provided by, a company affiliated with the financing appeared to
5 be at arm's length, at market rates, and with a revolving line of credit being debt serviced by
6 at all relevant times.

7 The court is mindful that it observed at the time it ruled on a motion for summary
8 judgment that and I "worked for entities related to and" but the
9 evidence has shown that their relationship with was, indeed, extremely attenuated.

10 Further, the relationship between and was fully disclosed to DCAA which did not
11 object to the relationship in any of its audit reports. The government may point out that it was not the
12 purpose of DCAA to ferret out fraud. However, it was the responsibility of DCAA to ensure that's
13 contract billings complied with FAR in all respects.

14 In sum, the government has failed to establish by a preponderance of the evidence that, and
15 were subject to common control, has successfully overcome the government's assertion
16 of common control.

17 Knowledge of Submission of False Claims

18 As a matter of law, because there was no common control between and, there
19 were no false claims submitted by to the government. In the alternative, even assuming common
20 control existed between and, the court finds that the government has failed to establish
21 by a preponderance of the evidence that either knowingly or recklessly submitted false claims.
22 The record shows that the relationship between and was repeatedly disclosed to DCAA.
23 Further, at the time of's formation, Senior Vice President of asked's
24 controller, to investigate whether the issuance of a purchase order to would
25 violate the "common control" proscription of the FAR regulations. After considering relevant factors
26 such as common ownership, management, facilities and contractual relationships, reasonably
27 concluded that its outsourcing of temporary labor purchase orders to was appropriate. The
28 court notes that the relationship between and is even more attenuated than the

1 relationship between _____ and the realty companies where the DCAA found that common control did
2 not exist (except for a limited period of time in 1992).

3 Further negating the element of knowledge, or reckless disregard, is ()'s repeated evaluations
4 of the circumstances between _____ and _____ regarding common control. The outsourcing of the
5 temporary labor services to _____ occurred only after A undertook an analysis of factors bearing
6 on common control. Further, the 1993 award of the janitorial services purchasing order occurred only
7 after a cost analysis was performed and disclosure was made to DCAA's on-site auditors. Again in
8 1996 DCAA conducted an audit of _____'s purchase orders to _____ and concluded that under
9 applicable FAR regulations that _____ and _____ were not related parties. The DCAA auditor, I
10 () concluded that no common control existed and the costs submitted by _____ were proper.
11 While the DCAA requested competitive bids, it did so not because of questionable costs but because
12 of related party issues. _____ fully complied with DCAA's request and, in a separate DCAA audit, the
13 DCAA concluded that the corrective actions taken by _____ complied with its recommendation. On this
14 record, Plaintiff fails to establish that _____ acted with the requisite state of mind.

15 For the foregoing reasons, the court finds in favor of _____ and against the government on all
16 claims.

17 IT IS SO ORDERED.

18 DATED: 6/12, 2003

19 _____
20 United States District Judge

21 cc: All parties
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25
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28