Voluntary Disclosure To The Government: Avoiding Unintended Consequences

Brett Johnson
Snell & Wilmer (Phoenix, AZ)

bwjohnson@swlaw.com | 602.382.6312
http://www.swlaw.com/attorneys/brett_johnson

Snell & Wilmer

VOLUNTARY DISCLOSURE TO THE GOVERNMENT:
AVOIDING UNINTENDED CONSEQUENCES

Brett Johnson

Objectives

- Understanding why Voluntary Disclosures are important
- Understanding the Voluntary Disclosure Process
- Best practices related to Voluntary Disclosures

Importance of Voluntary Disclosures

- Is a Voluntary Disclosure required by statute, regulation, or contract clause?
- Is there a mitigation rationale for making a Voluntary Disclosure?
- Is a Directed Disclosure required and non-affiliated events uncovered?
- Addressing whistleblowers or rogue employees?
- Reacting to trends in the enforcement environment.

Trends in Enforcement Driving Voluntary Disclosures?

- Increased investigations and audits
  - Pooling of resources
    - Cross-agency coordination
    - Multi-national investigations
  - Data mining
  - FERA – Delegation of Civil Investigative Demands
  - Increased audits
    - President Obama's budget
    - Example: Affordable Care Act unannounced visits to providers required.
- *Qui Tam* Lawsuits (competitors, employees, etc.)
- Shareholder derivative suits / RICO Actions

Case Example: United Technologies (2012)

- UTC subsidiaries (including Pratt & Whitney Canada)
  - Disclosed ITAR violations going back to 2002
- Main Violation: Software to China for military attack helicopters
- Charges:
  - 1. Illegal export
  - 2. Lying in self-disclosure
  - 3. Belated disclosure (mandatory because related to China)
- Lessons Learned:
  - Discovered during equity due diligence
  - (2) and (3) – post-lawyering up!
  - Rush disclosures versus getting it right
- Guilty Plea – Pratt & Whitney Canada (export suspension)
  - Deferred Prosecution Agreements for related companies
  - 75 million and monitor for 2 years

Case Example: Carondelet Health Network (2014)

- In 2010, internal audit found "documentation was lacking to fully support billing of inpatient rehabilitation services to federal health care programs"
  - Implemented new procedures and protocols to address those issues,
  - voluntarily disclosed certain overpayments, and
  - repaid $24 million
- Whistleblower action in 2011 (Allegation range – 2004 through 2011)
- Government determined that Carondelet's disclosure was "not timely, complete or adequate"
- Settlement: $33 Million (in addition to $24 Million)

Voluntary Disclosures (Pre-Event)

- Part of a compliance policy or program with direct responsibility to make determination
- Program that understands the applicable statutes and regulations that apply to a company's operations
  - Understand whether disclosure is mandatory or optional
- Well drafted agreements to insulate (mitigate) against third-parties and rogue employees
- Training Related to Program or Policy (laws)
- Audits
- Hotlines and Employee Exit Interviews (Seriously)

Voluntary Disclosures (Post-Event)

- Outside Counsel Early - Preservation Memorandum
- Internal Investigation
  - Understand the regulations or guidelines associated with Voluntary Disclosures
- Evaluating whether or not to disclose
  - Mandatory versus optional
  - Setting the factual story (ramifications for parallel litigation)
  - Waiving privileges
- Evaluating when to disclose
  - Specific regulations
  - Other events impacting the decision
- Federal Sentencing Guideline and other Regulations that Provide Mitigation
- Retain right to supplement Voluntary Disclosure
- Request confidentiality (FOIA)

Government Investigations

- Voluntary Disclosure process does not end!
- Communication is critical
  - Agreement with Investigators about parameters (avoid violating other laws (U.S. and foreign) in trying to cooperate)
  - Tolling Agreements
- Cooperation is key to prosecution decisions (strategic waivers of rights)
- Maintain communication log
- Keep track of documents/witnesses that are made available to the government
- The changing decision can be a corporate death penalty

Grappling With Incoherent Export Controls and the Art of Voluntary Disclosures
by Brett W. Johnson

United States industries have long complained about overbearing, difficult to understand and contradictory export control regulations. Many of the complaints are substantiated due to the multiple U.S. governmental agencies involved in export (and import) controls and the constant changes related to industry requests for long-term reform or responding to unfolding events within the international community. Companies regularly use outside consultants to perform the audit. However, there are significant risks associated with such audits, even though the consultant may be a trained export professional.

The art of drafting a voluntary disclosure does not start when the alleged export control violation occurs. Rather, a good voluntary disclosure begins in the creation and maintaining of a comprehensive export control policy and program, supported by senior management. A dedicated compliance manager also is a key best practice.

A good program will ensure proper classification of a company's products, services and technical data according to either the Commodity Control List of the Export Administration Regulations or the U.S. Munitions Lists of the International Traffic in Arms Regulations (ITAR). Many companies will have goods and services that are covered by both regulations, which is sometimes an ordeal in itself.

A good program will require products and services to be classified for import and export purposes against the Harmonized Tariff Schedule, which is maintained by the Customs and Border Protection, and the Schedule B, which is maintained by the Census Department. Finally, a company following a good program will ensure that the product is properly classified as to the regulations of other niche agencies, such as the Food and Drug Administration, the Department of Energy or the Bureau of Alcohol, Tobacco, Firearms and Explosives. Once the products and services are classified (which may continuously change) and the company understands what controls are necessary in regard to facility tours, transfer of technical data to foreign partners, or licenses to export goods and services, a company following a good program will ensure that it is screening its vendors, customers and other stakeholders, such as consultants, sales representatives or distributors, against the various export control lists. There are several lists maintained by the U.S. Department of Commerce, U.S. Department of State and the Office of Foreign Asset Control, among others. If an individual, entity, or country is on the lists, then the company either cannot do business with the identified party or it is required to obtain a governmental license to conduct such business. In addition, if the ITAR is implicated, the third party stakeholder may need to register as a broker to be involved in the transaction.

As part of a good export control program, a company will ensure that its agreements and purchase orders include either required language as to export controls or other language to mitigate against unforeseen violations by the third-parties (or someone else within the supply chain). Unfortunately, in the rush to conclude a deal (some of which are not even that lucrative), companies allow contractual terms to be made that provide minimal to no protection as to export controls or anti-corruption, among other issues.

Once the policy and program are put into place on paper, the company should train its employees and stakeholders on the policy, the law and the ramifications for violations. These ramifications could include losing the privilege to export, extra scrutiny on export shipments, civil fines, government contract debarment, and even criminal penalties for the company and individuals involved. No business transaction is worth going to prison. Training should occur regularly. If ITAR is implicated, the empowered official should ensure additional training.

A good program will also include audits. A best practice is to conduct an internal audit every six months, along with an outside audit by a trained professional every three years. Companies regularly use outside consultants to perform the audit. However, there are significant risks associated with such audits. The primary risk is if a possible violation has occurred, the consultant is not bound by the duty of confidentiality and the attorney-client privilege is not applicable. Thus, everything the consultant may have learned (even if incorrect) can be disclosed not only to the government, but also to competitors, shareholders or other third parties during litigation. Courts have recently heavily scrutinized audits and internal investigations conducted by non-lawyers, even if the company's in-house general counsel directed the audit or internal investigation.

Although the purpose of this article is to discuss voluntary disclosure, the fact that term is only now being referenced reflects how important preparing for

a voluntary disclosure begins well before an alleged violation occurs. But, violations of export controls do regularly occur. A company can never eliminate the risk of an export control violation due to so many unknowns, including rogue employees, unscrupulous independent parties, and unwary so-called end-users that do not understand the importance of export control due diligence, let alone know how the export control regulations are actually applied.

As part of a good export control program, a company will have a game plan established as to how to deal with alleged export control violations and determining whether a voluntary disclosure is warranted. First, the facts of the alleged violation need to be established and compared against the regulations allegedly violated. Depending on the degree of risk associated with the violation, many companies retain outside counsel to conduct an internal investigation as to the allegations and make a report as to what occurred and what violations may exist. Time is of the essence as to such investigation and deciding midway through an internal investigation that an outside counsel should be leading the effort is difficult because of the possibility that witnesses (and documents) are tainted. Regardless, the facts should be gathered and analyzed quickly.

Once an alleged violated has been confirmed (which is different from whether a violation has been verified), the company should consider, with the assistance of counsel, whether or not to make a voluntarily disclosure to the government agency that has jurisdiction. Even if a violation is not verified, but the company is concerned that the government may investigate (or a future deal, such as an acquisition or merger, will be at risk), then a voluntary disclosure might be warranted. There are rare occasions not to voluntarily disclose.

The main reason that a company might wish to make a voluntary disclosure is because it is able to first establish the facts upon which any future inquiry is made. It is also able to describe the export control program that it has put in place and that the violation was a variation. Then, the company is able to explain what action it took in response to the alleged violation, including mitigating the transaction (e.g., recovering the goods, ceasing the transaction, etc.) and disciplinary action, if warranted, against the employees involved.
Another primary reason to voluntarily disclose a violation is the mitigation of any potential penalty. In some rare cases, a voluntary disclosure may actually be required by law. Most governmental agencies want to see that the violation was fixed and issue a letter not to do it again. But, some violations do warrant penalties. By voluntary disclosing, a company is more likely to get a warning or lesser penalty than the company that does not disclose. In fact, the U.S. Sentencing Guidelines and applicable governmental agency regulations specifically highlight the mitigation benefits earned due to a voluntary disclosure.

Once a company decides to make the voluntary disclosure, it must be done correctly. There is an art to voluntary disclosures. But, it is not a secret. Most governmental agencies have specific regulations that discuss how and to whom a voluntary disclosure should be made. It is possible that a voluntary disclosure will need to be made to multiple governmental agencies, not only in the United States, but also in foreign countries. For example, an export violation may be considered a breach of a government contract. Both the agency responsible for the violation and the contracting officer responsible for the breach would need to be notified – using different regulatory frameworks.

It is important to provide all the relevant facts as required by the regulations. The failure to provide adequate facts can lead the government to determine that the voluntary disclosure was inadequate (or even false) and not only eliminate any mitigation benefit, but cause additional violations. In addition, the mitigation steps discussed above should not be window-dressing. Rather, the company needs to ensure such mitigation steps actually took place. Finally, a company should retain the right to supplement the voluntary disclosure if new facts arise.

After a voluntary disclosure is submitted, the governmental agency will review the submission as to adequacy. The disclosure may be shared with other agencies to assist in the review or determine additional jurisdiction. The government may request additional information from the company or require that the company perform an outside audit by an approved third party. They may require their own investigation, which would include interviewing personnel. In a worst case scenario, the matter may be so egregious that criminal investigators serve a search warrant. A company must understand that a casual call from the government after a voluntary disclosure is not actually casual. All contact should be coordinated through one company representative and any information provided can and will be used against (or for) the company in the future. All of these scenarios should be discussed before the voluntary disclosure is submitted, regardless of how remote. This discussion is important to ensure a

game-plan is in place as to how to respond to future governmental action.

As referenced above, the voluntary disclosure may result in just a warning letter, with the caveat that the government can use the incident against the company in the future if another violation occurs. But, the company may face administrative or judicial proceedings (civil or criminal). The voluntary disclosure (or lack of one) could be used during these proceedings to either assist or hinder the company. If the voluntary disclosure is well written, factually inclusive and accurate, and meets the regulatory requirements, it can be used as a shield during such proceedings and shape the entire proceedings. A poorly written voluntarily disclosure will have the opposite effect and would be considered an admission against the company during the proceedings. Again, if penalties are considered, a well-written voluntary disclosure will help in mitigation. Some large companies routinely make voluntary disclosures to the government. However, most companies will not have such experiences. A voluntary disclosure should not be taken lightly and it may be a "bet the business" endeavor because the company's inability to export or bid on government contract opportunities would be a death sentence. A person who dabbles in art is not likely to paint museum worthy masterpieces. The same principal applies to drafting, submitting, and addressing the long-term impact of voluntary disclosures. Companies should prepare well in advance for a possible violation. When necessary, a company should consider seeking outside assistance in trying to grapple with the myriad government regulations related to international trade in general and the need to submit a voluntary disclosure when necessary.

Government Contracting, the False Claims Act and the Art of Voluntary Disclosures
by Brett W. Johnson

With the end of the high levels of government contract spending during the Great Recession and the advent of sequestration and budget cuts, government contractors are competing for fewer and fewer opportunities. As this is occurring, government contracting officers, inspector generals, third-party contract administrators and law enforcement are significantly increasing their collective investigations of fraud, waste, and abuse and related False Claims Act and other statutory violations. Government contractors must prepare for these issues well in advance and ensure a well-developed plan is in place to investigate, evaluate, possibly report and respond to an investigation related to government contracting activities.

It seems like almost every day the government is either reporting the investigation or the settlement and prosecutions of government contractors and government employees for activities related to the False Claims Act. This statute prohibits government contractors, among others, from obtaining payments from the government based on fraud. To be liable, the government does not have to provide that the government contractor knew it was defrauding the government. Individuals and companies have been held liable or settled False Claims Act cases where the only evidence was that the government contractor had a culture of "deliberate ignorance" or "reckless disregard" for the fraudulent acts. In fact, the government contractor does not even need to have had an economic benefit from the fraudulent act to be liable under the False Claims Act.

The government discovers alleged False Claims Act violations in a variety of ways. Due to specific laws and regulations, such as Federal Acquisition Regulation Clause 52.203-13, actually requiring a contractor to disclose "credible evidence" of a violation, self-disclosures are increasing as one of the main initiators of a False Claims Act investigation. The government is also "data-mining" invoices to determine discrepancies and over-charges. Many agencies are also mandating audits by prime contractors of subcontractors to ensure potential violations are discovered. This is in addition to the traditional law enforcement techniques to root out fraud, waste and abuse.

But, the government is also receiving a significant increase of whistleblower complaints against government contractors via hotlines, disclosures or qui tam lawsuits. These complaints are sometimes made by competitors or subcontractors. However, the majority of reporters are internal employee whistleblowers that are either frustrated by attempts to fix the problem within the company or are disgruntled for a variety of reasons, including being fired or demoted from a position. A national network of whistleblower plaintiffs' attorneys now exists to assist whistleblowers with qui tam lawsuits and that may result in a quick and lucrative settlement.

A voluntary disclosure by a company before a whistleblower complains or the government discovers the alleged conduct is a very important tool to mitigate

risk. But, even when government contractors attempt to voluntary disclose, the government is determining that the voluntary disclosure was inadequate. For example, the government recently announced a $33 million settlement involving Carondelet Health Network in Arizona for False Claims Act violations. The government acknowledged that Carondelet did voluntary disclose the overpayment issues that were the underpinning for the settlement. However, the government determined that Carondelet's voluntary disclosure was "inadequate, untimely, and not complete." Since the matter resolved in a settlement, it is unclear exactly what the government meant by this determination and what caused Carondelet to lose out on possibly mitigating the alleged violations.

However, through the Carondelet announcement, other recent settlements, and recent interactions with various government agencies related to voluntary disclosures, a few "best practices" can be gleaned. First, the government contractor must have a policy in place to handle fraud, waste and abuse. If the government contract includes FAR Clause 52.203-13, such a policy is a contract requirement. Regardless, every government contractor should, at the minimum, have an ethics policy in-place and should seriously consider putting in-place a complete program to address fraud, waste and abuse matters, including the use of hotlines. Government contractors should announce (regularly) the policy from senior management to show the highest levels of concern and establish a "culture of compliance." The government contractor should train its employees and other stakeholders (e.g., subcontractors) about the policy. Finally, the company should regularly audit for potential problems.

If a complaint is raised, even if informally, the government contractors should immediately investigate the matter. Government contractors should have a process in place to handle such investigations. But, recent court opinions have questioned the ability of companies—especially government contractors—to retain a privilege by conducting an investigation with non-lawyers, even when the investigation is at the direction of the government contractor's legal department. Therefore, government contractors should seriously evaluate the delegating of any investigation to internal employees or external non-lawyer consultants. Retaining knowledgeable outside counsel is often the more prudent decision. The stakes are just too high.

Once the investigation is timely completed, the government contractor will need to decide whether to voluntarily disclose the allegation—regardless of whether the allegation actually has merit. The failure to voluntarily disclose eliminates any potential mitigation. In addition, by voluntarily reporting first, the government contractor is able to set the stage for the government investigation, reference the potential claimant, explain what steps the government contractor took to investigate the allegation, the investigation results and any internal mitigation that was taken to address the allegation. On the other hand, the government may never have discovered the alleged violation and the government contractor would not have suffered the sometimes unbearable scrutiny of a government investigation. The decision to voluntarily disclose should not be taken lightly, and you may want to involve outside counsel in evaluating this decision.

If the government contractor decides to voluntarily disclose, the written disclosure must be complete and adequate. If more time is needed, then this should be requested to allow a supplementation of the initial disclosure. Many governmental agencies have specific regulations or guidelines about how a government contractor should voluntarily disclose. A "data dump" of allegations, speculation, innuendo or gossip is inappropriate. Rather, a well-defined description of the facts should be available from the investigation, which is preferably done by attorneys to maintain necessary privileges. In addition, the information discussed above concerning adequately setting the stage for an investigation must be considered for inclusion. Finally, if the government requests that a form be used or included in the disclosure, the government contractor should comply with the request and then forward the voluntary disclosure to the required and appropriate government representatives. This may include the contracting officer, Office of Inspector General, or other point of contact.

Once a voluntary disclosure is made to the government, the government contractor must be ready to cooperate with any governmental investigation. This may include interviews of employees and requests for records. But, the government contractor should make sure the law is followed in regard to such investigations and ensure that its competitive advantage is not unduly impacted. For example, if a government contractor turns over internal documents to the governmental investigator, the government contractor should make sure that adequate protections against disclosure to others pursuant to the Freedom of Information Act (or similar State laws) are in place. In regard to interviews of employees, the government contractor should

ensure that labor laws and union rights are respected. A knowledgeable outside counsel can proactively assist and buffer the government contractor regarding coordination of the investigation and help avoid any unintended miscommunications.

The goal of any voluntary disclosure is to handle the issue at the lowest possible level and before the matter is referred to prosecutors or civil attorneys at the U.S. Attorney's Office or State Attorney General's Office. If the voluntary disclosure is done well and the investigative agency believes that the disclosure was adequate and the government contractor took adequate steps to address the allegations, it is possible that the case will be closed without litigation or settlement.

But, if referral for prosecution or civil action does occur, the government contractor is hopefully in a better position through its preparation, well written voluntary disclosure and pro-active cooperation with the government. The government prosecutors and civil litigators actively encourage voluntary disclosures. This is supported by the various governmental agencies. Therefore, voluntary disclosures are likely to become the norm in the future to ensure the government contractor is able to mitigate any allegation (regardless how baseless) and ensure the ability to continue to compete for government contract opportunities. Government contractors should understand these issues and prepare accordingly.

Faculty Biography: Brett Johnson

Partner | Snell & Wilmer | Phoenix, AZ

602.382.6312 | bwjohnson@swlaw.com
http://www.swlaw.com/attorneys/brett_johnson

Brett Johnson represents businesses and individuals in government relations matters. His practice includes international transactions and compliance, export, government contracting and health care matters, including professional liability defense and commercial litigation. Brett regularly represents parties and witnesses involved with governmental investigations, including export control, False Claims Act, Foreign Corrupt Practices Act, and government procurement compliance laws and regulations. He has experience handling internal investigations and compliance audits for clients on a wide range of matters. Brett also provides training to businesses and governmental agencies concerning compliance matters and the drafting of related corporate policies.

Brett advises and represents businesses in relation to negotiating and complying with government contracts. He negotiates and drafts government subcontracts and compliance programs related to, among others, the Buy American Act, Small Business Subcontracting Plans and Ethics policies. Brett also represents businesses before the Court of Federal Claims, Government Accountability Office, Boards of Contract Appeals, Small Business Administration, state, county, city, and other judicial bodies in regard to government procurement bid protests, claims, equitable adjustments, small business size determinations, certifications challenges and other disputes related to complying with government acquisition laws and regulations.

Brett also advises clients in regard to litigation subpoenas, Grand Jury Subpoenas, governmental administrative subpoenas, and other government requests for information. He regularly handles Freedom of Information Act and Privacy Act requests and defends against competitors who seek proprietary information through such authorities. Prior to joining the firm, Brett was a judge advocate with the United States Navy, regularly appearing in state and federal courts throughout the nation on behalf of the Department of Defense.

In addition to representing large and small businesses, individuals and pro bono clients, he is the co-chair of the firm's International Industry Group and the editor of the firm's International Industry Group's Global Connection newsletter. Brett also serves on the firm's Attorney Development Committee.

Education

- International Import-Export Institute -- Certified U.S. Export Compliance Officer (2008); Certified ITAR Professional (2009)
- Lex Mundi Institute, Program in Cross-Border Dispute Resolution (Summer 2008)
- University of Maryland, University College (Masters, Int'l Management, 2006)
- United States Naval War College (Completed Program in Strategic Studies, 2004)
- The Hague Academy of International Law, the Peace Palace -- The Netherlands (Summer 2003)
- University of San Diego School of Law (Masters of Law, International Law, 2001)
- Santa Clara University School of Law (J.D., 1999) -- 1999 Honors Moot Court Board, Director; Phi Delta Phi Honors Fraternity, Secretary
- Santa Clara University (B.S., Political Science, Minor, English, 1996)