



THE NEW STIMULUS ACT

Does It “Federalize” State and Local Contracts? Does It Change the Risk Calculus for Contractors Performing Public Contracts?

“The American people are watching. They need this plan to work. They expect to see the money that they've earned — they've worked so hard to earn — spent on its intended purposes without waste, without inefficiency, without fraud.”

President Obama to U.S. mayors, February 20, 2009

The sheer scope of the \$140 billion in construction spending authorized by the newly enacted American Recovery and Reinvestment Act of 2009¹ (popularly known as the “Stimulus Act”) is certain to accelerate the ongoing market shift from private to public construction spending. This shift has caused traditional private sector contractors to pursue public work, many for the first time. For contractors already experienced in public works as well as newcomers to the public contracts marketplace, an important question to consider is whether the baggage of the Federal Acquisition Regulations (commonly known as the “FAR”) will accompany contracts funded by the Stimulus Act.

The short answer is “no;” the Stimulus Act imposes the FAR only on contracts with a federal agency. Stimulus Act-funded projects entered into with state and local governments are not governed by the FAR, but are instead subject to the governing state and local procurement laws. This short answer, however appealing, is nevertheless an incomplete answer. Just as FAR clauses and requirements may be incorporated into federally funded state and local contracts on an agency-by-agency and contract-by-contract basis and federal grant rules may impose elements of the FAR, contracts funded by the Stimulus Act may still be subject to FAR terms, depending on the specific terms of the contracts.

Essentially, the good news that the FAR will not automatically apply to all these projects has to be tempered by concerns that should accompany all government contract work. For example, an important issue that should be addressed by contractors is the level of risk that Stimulus Act contractors will assume. The answer is that all Stimulus Act contracts – at the federal, state and local levels – will be subject to careful scrutiny by auditors for fraud, waste and abuse. In fact, we believe that the government is going to be more watchful about fraud, waste and

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¹ American Recovery and Reinvestment Act of 2009, P.L. 111-5, February 17, 2009 (the “Stimulus Act”).



abuse than ever before, as politicians have made that concern a centerpiece of arguments by both those who support and oppose the Act. After passage of the Act, the Obama Administration issued a directive that “fraud, waste, error, and abuse” must be “mitigated” and cost overruns must be avoided with Stimulus Act-funded contracts. Wasteful spending and poor contract administration of Stimulus Act contracts may be investigated by the federal Inspector General (“IG”) of the contracting agency and by the newly constituted Recovery Accountability and Transparency Board.

In addition, even if the FAR does not apply to state and local contracts, this does not mean that federal ethics laws will not apply. For example, Stimulus Act-funded contracts with state and local governments may be subject to the federal False Claims Act depending on whether payment requests are approved by the federal government.² Finally, although the recently enacted FAR ethics regulations requiring federal contractors to institute compliance programs and to “self-disclose” ethics violations³ will not be imposed on state and local contractors, those requirements will still apply to federal contracts funded by the Stimulus Act.

All of this suggests that, although contractors with state and local contracts funded by the Stimulus Act will not have to deal with the same FAR baggage as federal contractors, elements of the FAR may still apply, and all Stimulus Act contractors must understand that the current tide of ethics enforcement will only continue to rise.

The Stimulus Act’s Treatment of the FAR

Both the House bill⁴ and the original Senate bill⁵ would have imposed the FAR on all projects funded under the Stimulus Act, whether contracted directly with a federal agency or through a grant to a state or local government. In effect, these bills would have placed contractors with state and local contracts in the same position as contractors with the federal government. The final Senate compromise bill, however, pulled back from this blanket application of the FAR, and instead limited the FAR’s application to federal projects only.⁶

² See Peckar & Abramson’s Client Alert, [The U.S. Supreme Court Interprets the “Presentment” Requirement of the Federal False Claims Act, and Adds Intent and Materiality Requirements](http://www.pecklaw.com/PDF_files/Client_Alert-Supreme_Court_Interprets) (June 2008); http://www.pecklaw.com/PDF_files/Client_Alert-Supreme_Court_Interprets. Given the heightened level of federal oversight of expenditures that is required by the Stimulus Act, it seems likely that the federal FCA will apply to many Stimulus Act state and local contracts.

³ See Peckar & Abramson’s Client Alert, [New Federal Regulations require Contractors to “Self Disclose” violations of Federal Criminal Laws, violations of the Civil False Claims Act, and Overpayments on Contracts](http://www.pecklaw.com/PDF_files/Client_Alert-New_Fed_Regs) (November 2008); http://www.pecklaw.com/PDF_files/Client_Alert-New_Fed_Regs.

⁴ H.R. 1, Section 1205. Special Contracting Provisions (January 28, 2009):

The Federal Acquisition Regulation shall apply to contracts awarded with funds made available in this Act. To the maximum extent possible, such contracts shall be awarded as fixed-price contracts through the use of competitive procedures.

⁵ Senate Amendment 570, Section 1608, Prohibition on No-Bid Contracts and Earmarks (February 7, 2009):

(a) Notwithstanding any other provision of this Act, none of the funds appropriated or otherwise made available by this Act may be used to make any payment in connection with a contract unless the contract is awarded using competitive procedures in accordance with the requirements of section 303 of the Federal Property and Administrative Services Act of 1949 (41 U.S.C. 253), section 2304 of title 10, United States Code, and the Federal Acquisition Regulation.

⁶ Stimulus Act, Section 1610:

(a) None of the funds appropriated or otherwise made available by this Act, for projects initiated after the effective date of this Act, may be used by an executive agency to enter into any Federal contract unless such contract is entered into in accordance with the Federal Property and Administrative Services Act (41 U.S.C. 253) or chapter 137 of title 10, United States Code, and the Federal Acquisition Regulation, unless such contract is otherwise authorized by statute.



The conference report for the Stimulus Act offers little or no explanation for the elimination of the blanket FAR requirement, but it is known that representatives of the construction industry lobbied to limit the FAR requirements to federal procurements only. The industry apparently convinced Congress that requiring state and local governments to suddenly conform their procurement practices to an unfamiliar federal regulatory framework would inject confusion and risk into a Stimulus program whose goal is to encourage swift economic activity. However, as discussed in this Client Alert, elimination of the mandatory blanket application of the FAR does not mean that FAR requirements may not be imposed in a given contract.

Note that, although the FAR's requirements for competitive contracting do not apply to state and local contracting under the Stimulus Act as enacted, the Obama administration is nevertheless committed to maximizing competition in contracting. On February 18, 2008, the White House's Office of Management and Budget ("OMB") issued to all federal agencies a detailed Memorandum entitled "Initial Implementing Guidance for the American Recovery and Reinvestment Act of 2009." In describing procurement practices for Stimulus Act contracts, the OMB directed that, "Agencies should review their internal procurement review practices to promote competition to the maximum extent practicable." Therefore, competitive contracting practices mandated by the FAR may be implemented, even if the FAR itself does not apply.

State and Local Procurement Not Free of Federal Strings

The final Stimulus Act language removing the blanket application of the FAR does not mean that Stimulus Act contractors are free from the FAR's requirements. To the contrary, contractors performing state and local construction contracts funded by federal appropriations can be made subject to FAR compliance. Whether by agency rule, as a condition attached to a grant, or by the inclusion of FAR requirements in a state or local solicitation for bids, contractors performing state or local contracts are often required to comply with key requirements of the FAR. Common examples include the inclusion in state highway contracts of various federal labor, affirmative action and employment practices requirements, such as the Davis-Bacon Act requirements found in FAR 52.222-6. The federal agencies disbursing Stimulus Act funds to state and local governments will surely continue their practice of imposing these FAR socio-economic requirements on Stimulus Act-funded projects.

Oversight of Procurement Integrity

As discussed in detail in earlier Peckar & Abramson Client Alerts,⁷ the depth and breadth of federal contractors' procurement integrity obligations under the FAR have increased substantially over the past 18 months, culminating in the recently enacted FAR regulations requiring federal prime contractors and subcontractors to voluntarily self-disclose violations of federal ethics laws, the civil False Claims Act, and substantial overpayments. Contractors

⁷ See footnotes 2 and 3, above.



new to federal procurement must cope with these ethics requirements and train their workforces accordingly, with a full appreciation for the risks contractors face in pursuing federal work. This concern can only be intensified for contractors on Stimulus Act-funded projects because of the Act's commitment to transparency and accountability.⁸

Stimulus Act contractors will be under the microscope for fraud, waste and abuse. All funds expended under the Stimulus Act are subject to audit under the "Accountability and Transparency" provisions under Title XV of the Act. A Recovery Accountability and Transparency Board has been established whose powers include "auditing and reviewing covered funds to determine whether wasteful spending, poor contract or grant management, or other abuses are occurring and referring matters it considers appropriate for investigation to the inspector general for the agency that disbursed the covered funds." The Board is authorized to conduct its own audits, as well as collaborating with the IGs of the agencies, and will exercise the full investigative powers afforded IGs under the Inspectors General Act of 1978, including the power to issue subpoenas. These oversight responsibilities are to be coordinated with state auditors. Contractors thus face possible investigations for fraud, waste and abuse from at least two and possibly three sources – the Recovery Accountability and Transparency Board, the agency IGs, and, if a grant project, a state or local IG.

The Stimulus Act thus gives the federal government additional tools to prevent, detect and prosecute fraud, waste and abuse. The commitment to use these tools to carry out President Obama's promise not to permit waste, inefficiency or fraud is reflected in recent Administration policy directives. The OMB Memorandum issued to federal agencies on February 18, 2008 identifies the Obama Administration's accountability objectives as:

- Funds are awarded and distributed in a prompt, fair, and reasonable manner;
- The recipients and uses of all funds are **transparent to the public**, and the public benefits of these funds are reported clearly, accurately, and in a timely manner;
- Funds are used for authorized purposes and **instances of fraud, waste, error, and abuse are mitigated**;
- Projects funded under this Act **avoid unnecessary delays and cost overruns**; and
- Program goals are achieved, including specific program outcomes and improved results on broader economic indicators.

The OMB Memorandum advises agencies to "give special attention" to determining the responsibility of federal contractors. Responsibility determinations are governed by Part 9 of the FAR, which in turn includes the recently enacted regulation requiring that contractors "self-disclose" ethics violations or risk suspension and debarment as well as disqualification

⁸ If federal contractors needed one more reason to be concerned about potential ethics violations, on February 20, 2009, the U.S. Court of Appeals for the Federal Circuit issued its decision in *Daewoo Engineering & Const. Co., Ltd.*, No. 2007-5129, affirming a decision by the lower court that assessed a \$50.6 million penalty against a contractor who had submitted an unsupported claim as a "negotiation ploy." The lower court ruled that the contractor's inflated claim was a fraudulent claim under the Contract Disputes Act and that the contractor had to forfeit its claim for \$64 million because of its false claim.



as a non-responsible bidder. The special attention to be devoted to responsibility determinations means that the potential risks associated with a contractor's failure to make a required disclosure have magnified.

The spotlight on fraud, waste and abuse intensified shortly after the passage of the Stimulus Act, when the IG of the U.S. Department of Transportation ("USDOT") issued a scathing report charging state and local contractors with failing to comply with federal costs accounting rules and with routinely seeking payment for unallowable costs. The February 5, 2009 IG's report, "Oversight of Design and Engineering Firms' Indirect Costs Claimed on Federal-Aid Grants," focused on the billing practices of designers and engineers under federal grants. Of the 41 firms that were audited, 21 were found to have charged unallowable costs to the USDOT and to state DOTs. The report's recommendations included requiring firms to certify on federally funded cost reimbursement projects that all indirect costs claimed are allowable, and granting state DOTs the authority to assess penalties against firms that claim unallowable costs. Because state DOTs will be the primary vehicles for many infrastructure projects under the Stimulus Act, the IG's proposed recommendations suggest that audit and enforcement on federal contracts will be strengthened with the flow of Stimulus Act funds, and that state and local contracts funded by the Stimulus Act will experience a level of scrutiny not heretofore seen.

Whistleblower Protections

The Stimulus Act also creates protections for state and local government and contractor whistleblowers. This includes anti-retaliation provisions that create a private right of action by a whistleblower against an employer who retaliates against the whistleblower for disclosing gross mismanagement or the waste of Stimulus Act funds, or a violation of a law, rule or regulation related to a covered contract. While the whistleblower protection provisions do not impose civil or criminal penalties against an employer, the Recovery Accountability and Transparency Board is empowered to order an employer to abate the retaliation, reinstate the whistleblower with back pay, and pay all costs and expenses, including attorney fees, incurred by whistleblowers in bringing their complaint.

Is My Risk Being Stimulated?

The Stimulus Act provides a much anticipated and much needed shot in the arm for the construction industry. In staving off the blanket imposition of FAR requirements, the industry can expect the procurement process to operate more smoothly than it would if the Stimulus Act had been enacted as it was originally passed. Nothing in the Act fundamentally changes the way public contracting will take place the U.S. – at the federal, state or local levels. For projects funded by the Stimulus Act, federal contractors will continue to be subject to the FAR, and state and local contractors may be subject to elements of the FAR depending on the terms of their contracts or grants and the procurement rules of the state and local agencies with which they have contracts. And, ethics laws such as the federal False Claims Act (as well as state and local ethics laws) will continue to apply to contractors.



Client Alert

Given the Obama Administration's vow to hold state and local governments accountable for fraud, waste and abuse in the administration and expenditure of Stimulus Act funds, state and local governments can be expected to significantly increase the level of their scrutiny of federally funded contracts. This, coupled with the broad audit and investigative powers that the Stimulus Act gives to federal IGs and the new Recovery Accountability and Transparency Board, will mean that contractors at all levels who engage in business practices that could be characterized as fraudulent will be at risk. For this reason, contractors would be well advised to ensure that their compliance programs are well designed and fully operational for preventing and detecting the types of potential ethics violations that can occur in the business sector or market in which they operate.