

WAGES OF SIN

Why lawbreakers still win government contracts



BY CHRISTOPHER H. SCHMITT

In the mid-1970s, Lockheed Aircraft Corp. was center stage in a scorching bribery scandal. Millions in secret payments were slipped to public officials and political parties around the globe, to curry favor and win government contracts. Stung by the blowback, the company promised stringent reforms. Two decades later, Lockheed was again in the spotlight, pleading guilty to paying off an Egyptian official to win a deal for C-130 cargo planes. Once more, the company was contrite. Standing before a federal judge in 1995, a top executive pledged Lockheed's "commitment to the highest ethical standards of conduct."

WAR MACHINE. An F-16 in production at Lockheed Martin's Fort Worth plant

In the years since, however, Lockheed's troubles have only grown. The company has been named in at least 33 more cases covering overcharges on government contracts, improper technology transfer to China, falsifying results of nuclear safety tests, job discrimination, environmental pollution, and more. These cases, some of which were in motion before the 1995 conviction, have produced at least \$145.3 million in penalties, settlements, and restitution. And at least 13 more cases are pending.

Lockheed Martin, as the company is known today, says it has a vigorous ethics and compliance program. And, it turns out, that promise is good enough for the Pentagon. Last October, despite the company's record, the federal government awarded Lockheed

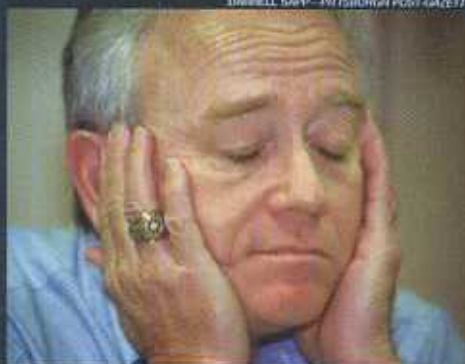
the richest military contract in history—a deal to build the nation's next-generation jet. The project, the F-35 Joint Strike Fighter, could be worth as much as \$200 billion over several decades.

Lockheed Martin is not the only big federal contractor that continues to do business with Washington despite repeated contract difficulties and other legal and regulatory trouble. In the past dozen years, 30 of the 43 largest federal contractors have racked up more than 400 enforcement cases, resulting in at least 28 criminal convictions, 286 civil settlements, and 88 administrative settlements, mostly involving their government contracts, according to data from the Project on Government Oversight, a nonprofit Washington, D.C., group that investigates government activities, and additional research by *U.S. News*. The companies have breached environmental, labor, and securities regulations as well. For their difficulties, the analysis shows, they have paid at least \$3.4 billion in fines, penalties, and restitution.

Injuries. The cases cover a wide swath, including price fixing, bogus testing, polluting, overcharging, hiding product defects, violating export laws, and withholding financial data from the government. They also represent more than accounting quibbles: Company workers have been killed and seriously injured and national security potentially put at risk. Yet, together, these firms have corralled more than 4 of every 10 federal procurement dollars. "If it was a food-stamp recipient, they'd go to jail," says Rep. Peter DeFazio, an Oregon Democrat, who complains about repeat offenders. "If it was a student-loan recipient who wasn't paying, they'd have their wages garnished. It's an extraordinary double standard."

The government actually has a process for cutting off wayward contractors from future work, but in practice, purchasing officers focus on getting projects done, not holding firms accountable for past behavior. And other officials responsible for barring firms can't legally use punishment as a motive, says Robert Meunier, head of a committee of those officials. "We're here to protect the government's business interest," he says. Even if a current contractor is prevented from doing future business, the company could continue to do billions of dollars' worth of government work under existing agreements. As best as can be determined, the government has cut off only one of the 30 big contractors with problems—General Electric Co.—and, even then, suspended the company for just a few days.

If federal agencies wanted to crack



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"They didn't want to make arrests of the higher-up people because it would damage the space program."

CHARLES H. PORTZ, attorney for James Verlander, shown above

SAFETY PROBLEM. A catapult captain launches an S-3B Viking from the flight deck of the USS John F. Kennedy. In 1995, Lockheed Martin, the plane's manufacturer, was found negligent in connection with the deaths of three fliers who perished when another S-3 crashed on takeoff from the same aircraft carrier off the coast of Virginia.



down on offending contractors, they couldn't. The U.S. government is the biggest shopper on the planet, buying some \$235 billion worth of goods and services last year—everything from military hardware to management of nuclear laboratories to food for school lunches. But

for reasons of cost, bureaucracy, and plain indifference, it doesn't keep tabs on the behavior of its vendors. Contracting officers don't know, for instance, if a company has already agreed with other agencies to clean up its act, and several agencies—including the General Services Administration—

BIG CONTRACTS

Repeat offenders

In the past dozen years, 30 of the federal government's biggest contractors have accumulated more than 400 enforcement cases, resulting in at least \$3.4 billion in penalties, settlements, and restitution. The top 10 firms:

CONTRACTOR	AMOUNT	NUMBER OF CASES	CONTRACTOR	AMOUNT	NUMBER OF CASES
General Electric	\$982.9 mil.	63	Archer Daniels Midland	\$208.2 mil.	8
TRW	\$389.5 mil.	17	Unisys	\$182.2 mil.	12
Boeing	\$358.0 mil.	36	Raytheon	\$128.7 mil.	24
Lockheed Martin	\$231.9 mil.	63	Litton*	\$111.5 mil.	8
United Technologies	\$214.8 mil.	18	Cargill	\$102 mil.	8

*Acquired by Northrop Grumman
Source: Project on Government Oversight; for more information, see www.pogo.org

Full table and report at www.usnews.com



can't even produce a list of whom they have suspended or barred from further contracts. In effect, contractors have no official history when they line up for government work.

Little guys. The military tops the government's buying list—with contracts for \$156.5 billion last year. Not surprisingly, some of the worst offenders are military contractors. But while the government may be reluctant to move against its biggest suppliers, federal agencies don't have the same qualms about cracking down on small firms. Officials maintain that federal rules are written evenhandedly, but they acknowledge that larger companies can navigate them more successfully.

Take James Verlander, a Houston-area researcher who in the early 1990s got tangled up in Operation Lightning Strike, a federal sting operation targeting NASA suppliers. Federal agents drew Verlander and several others into a scheme revolving around a bogus medical device that supposedly could improve monitoring of space-station astronauts. Threatened with a heavy prison sentence, he pleaded guilty to having accepted \$2,000

as part of an effort to win approval and funding for the device, says his attorney, Charles Portz. Banned from government work ever since, Verlander suffered a nervous breakdown and has since become a medical technician. By contrast, two big contractors that came under scrutiny in the affair—Martin Marietta and General Electric—settled their involvement by paying \$1 million to defray the government's expenses. "They didn't want to make arrests of the higher-up people because it would damage the space program," says Portz, "so they busted a bunch of little people."

Small fry get nailed more often because it's more likely that senior executives were involved in any wrongdoing, say those familiar with the issue. And large contractors have more financial juice to make a case go away—to hire pricey legal talent, create compliance programs, or pay settlements. "They're pretty willing to settle it to stay in business," says Jacques Gansler, former undersecretary of defense for acquisition, technology, and logistics, who is now a professor of public affairs at the University of Maryland.

Oversight of military and other federal spending has been kneecapped in recent years—through budget cuts and under the banner of streamlining regulation—and new proposals would weaken it further. Reflecting those developments and changing priorities, federal prosecution of contract fraud has fallen sharply in recent years, as have attempts by federal agencies themselves to rein in abuse, according to government data obtained by the Transactional Records Access Clearinghouse at Syracuse University. Many expect enforcement efforts to suffer further still as homeland defense comes to the fore. U.S. Department of Justice officials did not respond to requests for comment.

Corporate crime. Even in extreme situations, the biggest firms don't face contracting's version of the death penalty. Take behemoth General Electric. In the early 1990s, problems including bribery and mispricing became so pervasive that the Pentagon's Defense Contract Management Agency took the unusual step of setting up a special investigations office just for GE. The office produced 22 criminal indictments of the company, its subcontractors, and employees, and recovered \$221.7 million. Although individuals were booted from future government work, the company was not, despite recommendations from frustrated investigators. Not barring the firm "is clearly a disincentive to forcing a major contractor to institute [change]," they said at the time. "Other remedial actions, including criminal prosecutions, did not seem to be effective." Since then, GE has been named in new cases, involving both its military and civilian businesses. GE spokesman Gary Sheffer says that the earlier cases involved a small number of people and that the company used the experience to tighten an already strong compliance program.

The takeover trend sweeping military contractors shows why it will be harder still for government to get tough with wayward contractors. In 1999, two units of Litton Industries, the Southern California electronics and shipbuilding firm, agreed to pay \$18.5 million after pleading guilty to federal fraud charges. In one of the biggest cases of its kind, Litton had paid more than \$16 million in illegal commissions to "consultants" in Taiwan and Greece for help in winning military contracts, then falsified its books and tried to lead investigators astray. Last June, Litton was acquired by Northrop Grumman Corp., itself the product of a 1994 megadeal. Fair or not, size matters. "If you need a nuclear submarine, you've only got two people left to buy it from,"

says Steven Schooner, a George Washington University associate professor and former official in the Office of Federal Procurement Policy. Northrop Grumman did not return calls for comment.

In some cases, misspent tax dollars are the least of the story. In 2000, a federal jury said United Technology Corp.'s Sikorsky Aircraft unit was negligent when it failed to warn the Army that unbalanced fuel loads could make its Black Hawk chopper uncontrollable. It awarded \$22.9 million to the families of four servicemen killed and two seriously burned in a crash during night maneuvers near Fort Chaffee, Ark., in Louisiana in 1999, the federal Occupational Safety and Health Administration cited shipbuilder Avondale Industries, a unit of Litton, for accidents and safety problems, including three cases in which workers fell to their deaths; overall, there have been nine deaths in recent years, including a worker impaled on a post and another crushed by a 4,800-pound bulkhead.

Buried alive. In its waning days, the Clinton administration issued new rules aimed at holding contractors more accountable by requiring contracting officers to consider not only a company's ability to do the job but also its overall record in complying with tax, labor, employment, environmental, antitrust, and consumer protection laws. The rules would have considered incidents like the 1997 deaths of two grain-bin workers at a plant run by Cargill Inc., a top contractor for the U.S. Department of Agriculture. The workers were buried alive by grain while unplugging a clog in a huge storage bin. Neither was wearing required safety belts, and OSHA judged the incident a violation of the highest gravity. Cargill maintains it was never cited.

Whatever the case, the incident has no bearing on future contracts: In one of its first acts, the Bush administration suspended, then later revoked, the Clinton-era rules. Current rules provide the potential to consider a contractor's total compliance record, by requiring that firms have "a satisfactory record of integrity and business ethics." But the rules are ill-defined, and buying officials rarely

seize the opportunity, Schooner says. For starters, any attempt to deny a company a contract will quickly draw a lawsuit, he says. On top of that, federal agencies, needing everything from bullets to office supplies, don't much like their buying plans upset. So purchasing officials think, "Why would I touch that with a 10-foot pole?" Schooner says.

The issue of contractors' repeat offenses hasn't attracted a wide following,

and the General Services Administration declined or did not respond to repeated requests for comment.

Although the largest contractors still regularly get into trouble, these firms, especially military contractors, have made improvements in their compliance programs. Companywide ethics training is not uncommon, and executives say that flouting the rules can be a firing offense. Some of the government's cases result

from voluntary disclosure by the firms themselves—although companies sometimes confess to protect their own interests. Still, human nature, coupled with pressure to meet aggressive financial goals, makes it impossible to root out all problems, maintain company executives and government regulators. Lockheed Martin policy, for instance, says it is essential for employees to speak out without fear of retribution. Yet in 1999, the U.S. Department of Energy ruled that Lockheed Martin fired a worker in retaliation for disclosing safety problems. "No program is any more perfect than the people responsible to make the program work," says Lockheed Martin spokesman James Fetig.

More sting. Those who urge getting tougher with habitual offenders say it's possible to do more, even with concerns about national security or the limited number of suppliers. Rather than letting offending contractors pay a penalty and move on, for instance, the government could require firms to agree in advance to give up future business following any new violation. Putting more sting in penalties for pollution or safety violations could spur

better compliance in areas not directly related to government contracts. And a public repository of enforcement actions could bring pressure for change, just as publicizing toxic emissions has spurred companies to cut back on pollution.

But unless someone lights a fire, history suggests any change will be a while in coming. Consider, for instance, new regulations that federal officials expect to finish this fall, aimed at improving oversight in nonprocurement areas such as government grants and loans. Work on the rule began under President Bush—the first one, that is. ●



OVERBILLING CLAIMS. Northrop Grumman's Stealth bomber

but concerns are bipartisan. "To me, I'd say, 'One strike and you're out,'" says Rep. Bob Barr, a Georgia Republican on the House Government Reform Committee. "The government should not do business with corporations that are unethical." Rep. Carolyn Maloney, a New York Democrat also on the reform committee, says she'll introduce legislation requiring tracking of contractor problems, a system she battled to create while a city council member in New York City. "There's no reason to be giving a contract to a repeat violator," she says.

Officials from the Pentagon, the Bush