Knowing Your Way 'Around Washington'

LAW: Complying With Federal Contracting Rules Requires Expert Guidance

Louis Victorino

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— Louis Victorino and Jonathan Aronic Sheppard Mullin Richter & Hampton LLP partners

Jonathan Aronie

■ STAFF REPORT

President **Obama** does not trust defense or other governmental contractors, and he's deployed an army of auditors to determine whether his mistrust is misplaced. The best protection, say San Diego attorneys who work in the government contracting sector, is an active compliance department and constant vigilance.

This is big, big business in San Diego. There are about 600 government contractors in San Diego County, who have been awarded more than $2.3 billion in government contracts.

"From the moment President Obama stepped into office, his executive team made clear their distrust of defense contractors," said **Louis Victorino** and **Jonathan Aronie**, partners at **Sheppard Mullin Richter & Hampton LLP**. One of the Office of Management and Budget's "first public pronouncements focused on curbing perceived rampant contractor fraud. Shortly thereafter, Congress passed the Close the Contractor Fraud Loophole Act, certainly not the title one gives to an act intended to extoll the virtues of the long and critical partnership between government and industry."

Attorneys **Christian D. Humphreys**, managing partner of **McKenna Long & Aldridge LLP's** North County San Diego office, and **Kevin J. Lombardo,** an MLA partner in its Los Angeles office, agree. "Over the last few years, scrutiny of government contractors has risen dramatically as the government has expanded its auditing workforce and the number of government contracts has decreased," Humphreys said. "Claims against government contractors are becoming more and more prevalent during the current budget crisis — which could include alleged civil and/or criminal False Claims Act ("FCA") violations, Foreign Corrupt Practices Act ("FCPA") violations, bribery or false statement violations — often arise as a result of a routine government audit, a whistleblower complaint, a call from a federal agent, the issuance of a grand jury subpoena, or the execution of a search warrant."

Robust Compliance Programs

Harsh review for compliance means government contractors must have in place robust compliance programs that prevent possible violations and allow for prompt detection and corrective action, the attorneys agreed. A strong compliance program may prevent violations from ever happening, but if one does, a strong compliance program actively enforced is a good front line in defending against the government claim. If you do not have a strong compliance program, or your existing program has not been reviewed recently, a call to an attorney with government compliance experience is a good idea.

"In the event a claim arises, you will need to engage counsel with significant government contracts experience to guide you through the process and minimize the risk to you and your company," said MLA's Lombardo, who has significant experience conducting compliance audits, developing training programs, handling allegations of fraud, as well as investigating and resolving alleged violations. "Doing this work before a claim, however, helps everyone do a better job for you."

Scrutiny Has Some Merit

The government scrutiny isn't without some merit. "It would be naïve, of course, to think this increase in enforcement activity is due solely to a mistrust of contractors," Victorino said. "The government's collection of $4.9 billion (yes, that's billion with a "B") in False Claims Act settlements and recoveries in 2012 no doubt feeds the government's view that contractors need more policing, and fuels the arguments of the enforcement community that they need to be more, not less, aggressive."

Disagreements between a contractor and an agency over the government's bid decisions have increased every year since 2008. That trend will continue. "In 2008, 1,652 actions were filed with the General Accountability Office (GAO)…2,475 in 2012," said Aronie, of Sheppard Mullin. "As federal opportunities become fewer, the competition for those that remain almost certainly will heat up. In short, some companies simply cannot afford *not* to protest."

There will be fewer awards, too, because the president was heavily supported by government labor "unions" and he wants to hire more government employees. "We also likely will see that government engineering centers and laboratories will move to keep in-house significant research and development funding and activities," Victorino said. "These efforts will have an obvious significant impact on contracting opportunities available to private companies, large and small."

'Necessary Evil'

As a consequence of bringing more work in-house, the government will need the intellectual property necessary to perform that newly in-sourced work, said Aronie. "The government will seek to obtain, at a minimum, a Government Purpose Rights License not only to data first produced or developed under the contract but also to a significant portion of all data *used* in the performance of the contract," he said. "And, unfortunately, in some instances, contractor intellectual property simply will be used by the government, with the propriety of the use left to be determined by years of litigation."

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Recent legislation by Washington increases the need for an active compliance department for government contractors.

A good in-house ethics and compliance program was thought by some contractors as a necessary evil, said Humpheys, "something needed to keep the lawyers happy."

Most contractors today appreciate the benefits of an effective ethics and compliance program, and codes of conduct are standard. Training programs, in most cases, are routine for government contractors.

But there is still increasing risk for government contractors. "The 2013 market clearly counsels in favor of enhanced care in the pursuit of new business," Victorino said. "With respect to new solicitations, assure that the proposed terms and conditions are reviewed carefully and risks identified. Assure decisions to accept risk are fully informed and made at an appropriate level within the company."

Government's Search for Money Fuels Tax Attorney Work

TAX: Changes To Tax Laws Increase Need for Good Advice

■ STAFF REPORT

The political discord that ultimately lead to passage of the American Taxpayer Relief Act of 2012, or ATRA, drove a lot of legal business to San Diego tax lawyers, which was a financial relief, but a work burden.

"Last year was an extremely busy time for tax (attorneys)," said **Bruce M. O'Brien**, a tax law specialist and chair of the Tax Practice Group at **Higgs Fletcher & Mack LLP**. "With the uncertainty of the tax laws and whether we were going to have substantial across-the-board tax increases (part of the so-called "fiscal cliff"') many taxpayers undertook transactions and accelerated income when they otherwise might not have done so."

The tax act, ATRA, made many of the Bush-era tax cuts permanent for most taxpayers. Tax rates on ordinary income and capital gains generally remained unchanged except for high-income earners (those with taxable income above $400,000 for single filers and $450,000 for joint filers), according to Higgs Fletcher's O'Brien. The top income tax rates increased from 35 percent to 39.6 percent and the top capital gains rate increased from 15 percent to 20 percent. Prior to ATRA, dividends were scheduled to be taxed at ordinary income rates beginning in 2013. Instead, they will continue to be taxed like capital gains. The exemption from estate and gift taxes stayed at $5 million but the tax rate went up to 40 percent from 35 percent.

Ronson J. Shamoun

"That's better than what would have happened if nothing was done," he said. "The federal estate and gift tax exemption was scheduled to drop from $5 million to $1 million."

Other changes impacting higher income taxpayers include a phase-out of personal exemptions and a limitation on the amount that may be taken as itemized deductions.

The tax act, ATRA, may be only one aspect of the changing tax and collection business landscape. "While much of the public discussion regarding tax law recently has involved debate over federal income tax reform, we believe that there are two (additional) issues that will become increasingly important: worker classification and federal income tax collection efforts," said **Ronson J. Shamoun**, founder and principal attorney of **RJS Law.**

Worker Classification Is Key

One key tax issue beyond ATRA, according to Shamoun, is "worker classification," which is important to both businesses and governments, particularly the past couple of years. Classification deals specifically with whether workers should properly be considered for tax purposes as independent contractors or employees. Theoretically, businesses and the "employee" save money by not paying employment taxes.

While the IRS, the California Employment Development Department, and the California Labor Commissioner each have their own method for determining a worker's classification, they all focus on the extent of the employer's "control" over how a worker performs his or her tasks and duties. The classification is not discretionary; the employer must have "reasonable cause" for treating workers in a particular manner. Not only are businesses liable, but paid consultants or advisers, who advise businesses with regard to classification, could also be

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in 2013," said **Gordon & Rees** partner **Christopher Cato**. "Retaliation claims are often favored because they are viewed as easier to prove than actual discrimination or harassment claims. In essence, the employee has to establish only that he or she engaged in the protected activity, such as a complaint of discrimination or harassment, with a reasonable belief that some unlawful activity occurred, and that the protected activity was a motivating reason for an adverse employment action. The employee does not have to prove the complained of activity was actually unlawful."

Cato also anticipates a steady stream of wage-and-hour class actions, despite the **Brinker** decision, because this area of the law is so complex. "We also expect additional developments in the areas of e-discovery and cyber law, as courts and administrative agencies wrestle with how to handle electronic data, ever-changing technology, and the extent to which employers may regulate the use of social media by employees or use it to monitor employees," Cato said. "Overall, 2013 should be another busy year for employment lawyers."

Misclassification of An Employee

It is now unlawful for "any person or employer" to willfully misclassify an individual as an independent contractor, and not an employee. "The monetary penalties can be stiff — $5,000 to $15,000 for each violation, and if the state agency determines that the misclassification is part of a 'pattern or practice,' the monetary penalties ramp up to a minimum of $10,000 per violation, with a maximum of $25,000 per violation," said Duane Morris' Kearns. "Furthermore, a person or employer who has been found to have willfully misclassified workers as independent contractors will be required to post on an Internet page or prominently in the workplace a written notice, visible to the general public and employees, stating that the person or employer 'committed a serious violation of the law by engaging in the willful misclassification of employees.' Obviously, employers will want to avoid being required to make this posting (and paying the significant monetary penalties)."

The bad news for California employers does not end there. Labor Code amendments provide that an employer who knowingly and intentionally misclassifies workers as independent contractors is guilty of a misdemeanor and once convicted, can be fined up to $1,000 or imprisoned up to one year, or both (at the court's discretion). These criminal sanctions also apply to "any officer, agent, employee, fiduciary or other person who has the control, receipt, custody or disposal of, or pays the wages" of employees. "This could certainly be read to include CEOs or HR executives, and most certainly would include the person directly responsible for payroll," said Kearns. "However, an in-house HR person or an attorney who has advised the company to make such classification are not subject to the joint and several liability in the event that the employer is found to have misclassified."

Employees' Access To Their File

Another new law will have significant impact on all employers when they receive requests for personnel files from current or former employees. With the new year, employers must allow access to personnel files by a current or former employee or his or her representative. "Also, the statute outlines specific details as to the location for inspection and copying and imposes a penalty of $750 for non-compliance," said **Jim Peterson**, a partner at **Higgs Fletcher & Mack LLP**, and who is chair of the firm's labor and employment group. Peterson represents many notable companies both regionally and nationally and has been practicing labor and employment law in San Diego for 24 years. "Further, the employer must provide a copy of the entire file within 30 days of receipt of a written request, and maintain the personnel files for three years after the end of employment."


James Peterson

Social Media

The volume of laws and rulings that implicate social media will grow this year. Employers are now prohibited from requesting or requiring employees or applicants to disclose usernames or passwords for social media sites, and from requesting or requiring such persons to access a social media site in the employer's presence. But there are hidden issues. "An employer can request an employee to divulge social media which it reasonably believes is relevant to an investigation of employee misconduct, and employers can require disclosure of usernames or passwords to access electronic devices issued by the employer," Kearns said.

"And, several recent rulings of the National Labor Relations Board broadly construe social media postings by current or former employees to amount to protected concerted activity."

Peterson points out that the new law provides that an employer who requests the information but who does not discover or investigate a prospective employee's social media activity will not be subject to a claim for negligent hiring and preventing an employer from requiring employees to disclose username and password information for social media sites or employees and prospective employees.

These rulings can be read broadly enough to cover private, non-union employers, both Peterson and Kearns said. Employers should make sure that their policies are not worded in such a way that they could be interpreted to prohibit protected activity, for example, discussing working conditions or organizing efforts.

Bullying Is the New Claim

Workplace bullying is poised to become the next major battleground in employment law, said **Madeline Cahill-Boley,** managing partner at **Sullivan Hill Lewin Rez & Engel.**

"Think about sexual harassment claims of 25 years ago," she said. "Although there are no current federal or state laws prohibiting abusive work conduct absent attendant discrimination or workplace violence, numerous states have proposed anti-workplace bullying legislation. California was the very first. It is a developing area of employment law that is likely to create a broad cause of action for plaintiffs who will not need to be a member of a protected class in order to bring a claim."


Madeline Cahill-Boley

Employee bullying will likely become the biggest driver for workplace disputes in the coming years because it creates causes of action for anyone who experiences conduct of other employees that is creating a hostile environment, even supervisors who feel intimidated or threatened by subordinates.

Educating managers on the changing legal standards of appropriate workplace behavior is important. Conduct that many may find harmless or routine could still expose a company to legal risk. Specific training on bullying, said Cahill-Boley, will pay dividends far into the future as California moves into this additional phase of employment claims and litigation.

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if a case is settled early or under budget, etc.)."

At Fish, the firm is looking at ways to offer a variety of ways to improve efficiency. Brackett works with a small group of attorneys to develop new methods of billing and manage the fees. **Kurt Glitzenstein**, who heads the firm's alternative fee arrangement group, said the emphasis is on more than just competitive pricing. "What it really means is that it's putting more obligation on the law firms to work efficiently, and there are many ways we strive to do that," Glitzenstein said.

"Some clients have a lot of experience in negotiating alternative fees and are very comfortable in working with alternative fees and have their own ideas about what works for them," said Foley's Stagg, who primarily works in defending consumer class actions, unfair competition and false advertising allegations. "A lot of corporate law departments are requesting that alternative fees be included in any response to a Request For Proposal. But for many, I think it's an area where they are collecting the information about what is being offered but not necessarily acting on it at the present time or using it to select counsel. It takes some time for both the client and the law firm to evaluate if the alternative fee structure being used works for that relationship. It's very important to make sure both sides are communicating about what is included in the alternative fee and, more importantly, what is not."

Bob Tyson, co-founder of La Jolla-based **Tyson & Mendes**, said that if a company is interested in an alternative fee arrangement, they should "just ask." The arrangement must be beneficial to both parties, however. "One of the best incentives for a law firm to establish alternative or discounted fees is volume," Tyson said, whose firm focuses solely on litigation work. "Companies with multiple litigation matters a year may find a law firm more willing to work with them in establishing alternative fee arrangements in exchange for giving the firm a bulk of its litigation work instead of distributing cases out to multiple law firms."

Tyson has taken inspiration from famed trial lawyer **David Boise,** who represented **Al Gore** in the U.S. Supreme Court case *Bush v. Gore*. Boise is credited with revolutionizing the economics of law firms by building incentives into fee arrangements so value is based on results and not merely billable hours. Tyson & Mendes has embraced this concept and has established arrangements with some clients that include lower billable rates and a contingency based upon results.

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jointly and severally liable for willfully misclassifying workers.

"If an employer is investigated by the IRS and found to have misclassified its workers, the employer could face significant penalties and back taxes," said Shamoun, who has a master of laws in taxation. "As there is expected to be more classification audits of small businesses, it is important for employers to review guidance provided by the IRS, the EDD, and the Labor Commissioner to ensure their compliance."

O'Brien agrees the IRS and state taxing agencies are expected to step up their enforcement and auditing programs.

"Areas of emphasis by the Internal Revenue Service include promoting compliance by taxpayers holding offshore accounts and assets, identification and recovery of false refunds and abusive transactions, detection and prosecution of tax fraud, and collections from delinquent taxpayers," he said. "Similar programs are under way by the state tax agencies with additional emphasis on employee classification problems and auditing tax-deferred real estate exchanges."

Marital Deduction Decision Expected

Another change to the tax law could come this year from the U.S. Supreme Court. The case, *U.S. v. Windsor*, could determine the constitutionality of the Defense of Marriage Act, or DOMA. The case involves two women from the state of New York, who were married in Canada, where same-sex marriage is legal.

When one of the women died in 2007, the surviving spouse filed a federal estate tax return and paid $363,053 in estate taxes because she was not eligible for the unlimited marital deduction. She then filed a suit for refund in U.S. District Court in New York.

The marital deduction — under ordinary circumstances — allows an individual to transfer, generally either by gift while living or by will at death, any or all of his or her assets to a spouse without any tax consequences. The IRS, however, does not consider same-sex couples as "married" for purposes of the estate tax by virtue of the DOMA. In the *Windsor* case, however, a lower court ruled that DOMA is unconstitutional and that the surviving spouse was entitled to her refund.

The Supreme Court granted certiorari and oral arguments are scheduled for March.

A decision in the case may appear by the end of the year but, while awaiting the outcome of this case, and the Supreme Court's decision on California's Proposition 8, some practitioners recommend filing "protective refund claims" with the IRS to take advantage of tax benefits available to opposite-sex married couples. A protective claim is filed — either as a formal written claim or as an amended return — when the resolution of litigation will extend beyond the statute of limitations for filing a claim for refund, according to Shamoun.

Notwithstanding the recent clarity in the tax laws, tax professionals should continue to be busy in 2013 as the new laws are implemented and enforced, said O'Brien. "Taxpayers are always going to structure their transactions to minimize the tax consequences, and we can help them do that."