SEC. ___. ENHANCEMENT OF DEPARTMENT OF DEFENSE CAPABILITIES TO DETER AND RESPOND TO CONTRACTOR FRAUD.

(a) WITHHOLDING OF CONTRACTUAL PAYMENTS.—Subsection (a) of section 2207 of title 10, United States Code, is amended—

(1) by striking "unless that contract provides that—" and inserting "unless that contract provides each of the following:";

(2) in paragraph (1)—

(A) by inserting "That" after "(1)"; and

(B) by striking "; and" and inserting a period;

(3) in paragraph (2), by inserting "That," after "(2)"; and

(4) by inserting after paragraph (2) the following new paragraphs:

"(3) That with respect to a contract that could have been terminated under paragraph (1) but for the prior completion of the contract's performance, the United States is entitled to exemplary damages as set forth in paragraph (2), in accordance with the notice and hearing process set forth in paragraph (1).

"(4) That, with respect to a contract that is terminated under paragraph (1) or, as specified in paragraph (3), could have been terminated under paragraph (1) but for the prior completion of the contract's performance, the United States may, after notifying the contractor but pending the determination concerning exemplary damages referred to in paragraph (2), withhold from payments otherwise due to the contractor under any contract between the contractor and the military department or Defense Agency that entered into the terminated (or completed) contract an amount that is up to 10 times the

cost incurred by the contractor in giving gratuities to the officer, official, or employee concerned, as such cost is estimated by the Secretary.”.

(b) INAPPLICABILITY TO NON-DOD AGENCIES.—Subsection (b) of such section is amended—

(1) by inserting “(1)” after “(b)”; and

(2) by adding at the end the following new paragraph:

“(2) Paragraph (4) of subsection (a) does not apply to a contract awarded on behalf of a military department or Defense Agency by a department or agency of the United States outside of the Department of Defense.”.

(c) RETENTION OF DAMAGES; FRAUD FIGHTING FUNDS.—Such section is further amended—

(1) by redesignating subsection (b), as amended by subsection (b) of this section, as subsection (c); and

(2) by inserting after subsection (a) the following new subsection (b):

“(b) RETENTION OF DAMAGES; FRAUD FIGHTING FUNDS.—(1) Exemplary damages recovered under subsection (a)(2) may be retained by the Secretary of Defense, if recovered by a Defense Agency, or by the Secretary concerned, if recovered by a military department, without regard to section 3302 of title 31.

“(2) The Secretary of Defense and the Secretaries of the military departments shall each establish a ‘Fraud-Fighting Fund’ for use by the Defense Agencies, in the case of the fund established by the Secretary of Defense, or military department, in the case of a fund established by the Secretary concerned, which shall be available to provide funds, in addition to funds which may be otherwise available for activities including training, investigations, administrative

proceedings, enforcement actions, and other related activities associated with deterring and preventing fraud. Exemplary damages recovered under subsection (a)(2), shall be paid into the appropriate fund and shall be available until expended.".

(d) BURDEN OF PROOF.—Subsection (a)(1) of such section, as amended by subsection (a), is further amended by inserting "and by a preponderance of the evidence" after "after notice and hearing".

(e) TECHNICAL AMENDMENTS.—Subsection (a) of such section is further amended by striking "clause (1)" in paragraph (2) and in the flush sentence at the end and inserting "paragraph (1)".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to contracts that are awarded on or after the date that is 180 days after the date of the enactment of this Act.

(g) CONFORMING AMENDMENTS.—Section 2410m(a) of title 10, United States Code, is amended—

(1) by inserting "or arising from a recovery of exemplary damages under section 2207 of this title," after "of title 41";

(2) by striking "or" at the end of paragraph (2);

(3) by striking the period at the end of paragraph (3) and inserting "; or"; and

(4) by adding at the end the following new paragraph:

"(4) any determination under section 2207 of this title.".

(h) PROCUREMENT REGULATIONS.—Regulations governing actions under section 2207 of title 10, United States Code, shall be revised to implement the amendments to that section made by this section not later than 180 days after the date of the enactment of this Act.

Section-by-Section Analysis

This proposal would make four primary changes to section 2207 of title 10, United States Code, accompanied by a number of non-substantive changes. First, the proposal would amend section 2207(a) to require that any contract using funds appropriated to the Department permit the United States to assess exemplary damages under a breached contract, even if that contract has already been fully performed. Second, the proposal would amend section 2207(a) of title 10, United States Code, to require that any contact using funds appropriated to the Department (excluding contracts awarded on behalf of the Department by other civilian agencies) permit the United States to withhold contractual payments pending the resolution of allegations that the contractor improperly offered or gave a gratuity to an officer, official, or employee of the United States Third, the proposal would further amend section 2207 by adding a new subsection (b) authorizing the military departments and Defense Agencies to use any exemplary damages recovered pursuant to subsection (a) to support fraud-fighting activities. Fourth, the proposal would clarify the burden of proof applicable to proceedings conducted pursuant to section 2207.

First, as currently written, it is unclear whether section 2207 allows the United States to assess exemplary damages before a contract has been terminated due to the offer or gifting of an improper gratuity. This can result in the Government having no redress in the event of a tainted contract that has been fully performed. The Government should not be deprived of the remedies provided by section 2207 because of the timing of performance, which is irrelevant to the corruption problem section 2207 seeks to ameliorate. The Government frequently does not become aware of an alleged gratuity until after performance of a contract is complete, and so this aspect of the proposal would close a significant, inadvertent loophole.

Second, section 2007 is silent on whether the United States may withhold contractual payments for potential assessment as exemplary damages based on preliminary information that a violation occurred. Although the United States may have an implied right to withhold sums for exemplary damages prior to a final determination of a violation, there is no federal court ruling specifically affirming or rejecting the Government's right to withhold for exemplary damages under section 2207 or the contractual clause it requires before a final determination has been made by the department or Agency head or designee. Thus, the United States could be required make contractual payments to a malfeasant contractor while the proceeding required by section 2207 is underway, even if the United States knew that the contractor would immediately disburse all payments received on its Government contract, potentially even to employees or owners personally responsible for an illegal gratuity.

In this scenario, there would be no monies for the Government to collect as exemplary damages once the procedure required by section 2207 is complete. By incorporating a clear, explicit collection mechanism into the statute, the proposal would provide the United States with an efficient means to hold contractors accountable for wrongdoing. The proposal also would provide contractors with clear notice that corrupting or seeking to corrupt procurement personnel puts contract payments at risk. In the event that the allegations that the contractor offered or gave a gratuity to a Government employee or officer to influence the contract were not substantiated, any payments withheld that were due and payable under the contract would be subject to the Prompt Payment Act (31 U.S.C. § 3902).

The proposal, however, exempts contracts that Civilian Agencies enter into on behalf of a military department or Defense Agency (such as an assisted acquisition) from including the withholding clause. Without such an exemption, a situation could arise wherein a military department of Defense Agency might withhold money from a Civilian Agency contracting on behalf of a military department or Defense Agency, under section 2207, and that the money would constitute funds that Civilian Agency requires in order to pay a contractor performing under the assisted acquisition for a military department or Defense Agency. Because the Civilian Agency would not have similar authority to withhold payment to the contractor, the Civilian Agency would have no funds with which to pay the contractor, and might therefore be forced to withhold payment without the authority to do so.

Third, the proposal would also permit the military departments and Defense Agencies to retain exemplary damages recovered under section 2207 to support their fraud-fighting efforts. If properly assessed and recovered exemplary damages are used to fight fraud, the deterrent effect of those exemplary damages would be amplified in that both their assessment and their use will discourage fraud. Accordingly, the proposal would permit the Secretary of Defense and the Secretaries of each military department to create their own fraud-fighting fund. The Defense Agencies would be permitted to place exemplary damages collected from contractors into the Secretary of Defense fund, and the military departments would be permitted to place exemplary damages collected into their specific fraud-fighting funds. While section 2207 currently allows the Government to assess exemplary damages, section 3302(b) of title 31 requires that all money received for the Government from any source must be deposited into the U.S. Treasury as miscellaneous receipts. A primary exception to this rule is that an agency may retain and obligate funds that it collects if expressly authorized to do so by statute. Further, the statutory language permitting retention of money that is collected must specify the types of receipts that an agency may retain and the sources of those receipts. The proposed amendment to section 2207 meets these principals.

The Comptroller General has applied the requirement for specificity to agencies seeking to retain exemplary damage awards to fund other agency specific funds without the express authority to do so. There are a number of examples of statutory authority that permit agencies to retain monies received from a non-governmental source based on administrative procedures. For example, section 527 of title 28 permits the Department of Justice to place three percent of all amount collected by their civil debt collection litigation into a working capital fund.

Finally, the proposal would clarify existing law by explicitly incorporating the burden of proof applicable to a determination of whether section 2207 was violated in a specific instance. Currently, the Government applies a preponderance-of-the-evidence burden of proof to its determinations under section 2207. As the statute is civil in nature, that is appropriate. Including this standard in the statute would ensure that a military department or Defense Agency continues to apply section 2207 in a consistent manner and would provide Government contractors with a clearer understanding of their rights. The proposed change would make clear that section 2207 is not available if there is a mere suspicion of improper activity.

It is important to note, however, that the proposal would not make withholding of funds mandatory. The military department or Defense Agency head or designee would retain discretion as to whether withholding contractual payments is appropriate and in the public's interest. The proposed amendment would retain, and build upon, the existing notice and hearing protections provided to contractors by requiring notice to be provided before the commencement of withholding. Incorporating a civil burden of proof into the law is likewise consistent with preserving the rights of Government contractors under the statute. Finally, retaining exemplary damages collected from contractors who have paid improper gratuities would further bolster the Government's ability to deter and address acquisition and procurement fraud through the expenditure of monies collected from those who have perpetrated fraudulent schemes against the Government. Because use of the retained monies would be limited to that purpose, a fraud-fighting fund would not create an incentive for Government Agencies to pursue actions under section 2207 as an alternative method of funding its operations.

Budget Implications: This proposal has no budgetary impact. The Fraud Fund would be financed with exemplary damages assessed against the contractor and not with new budget authority.

RESOURCE REQUIREMENTS ($MILLIONS)									
	FY 2014	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**Appropriation From**	**Budget Activity**	**Dash-1 Line Item**	**Program Element**
Total	0	0	0	0	0	N/A	N/A	N/A	N/A

Changes to Existing Law: This proposal would make the following changes to sections 2207 and 2410m of title 10, United States Code:

§ 2207. Expenditure of appropriations: limitation

(a) Money appropriated to the Department of Defense may not be spent under a contract other than a contract for personal services unless that contract provides ~~that —~~ each of the following:

(1) That the United States may, by written notice to the contractor, terminate the right of the contractor to proceed under the contract if the Secretary concerned or his designee finds, after notice and hearing and by a preponderance of the evidence, that the contractor, or his agent or other representative, offered or gave any gratuity, such as entertainment or a gift, to an officer, official, or employee of the United States to obtain a contract or favorable treatment in the awarding, amending, or making of determinations concerning the performance, of a contract. ~~; and~~

(2) That, if a contract is terminated under ~~clause~~ paragraph (1), the United States has the same remedies against the contractor that it would have had if the contractor had breached the contract and, in addition to other damages, is entitled to exemplary damages in an amount at least three, but not more than 10, as determined by the Secretary or his designee, times the cost incurred by the contractor in giving gratuities to the officer, official, or employee concerned.

(3) That with respect to a contract that could have been terminated under paragraph (1) but for the prior completion of the contract's performance, the United States is entitled to exemplary damages as set forth in paragraph (2), in accordance with the notice and hearing process set forth in paragraph (1).

(4) That, with respect to a contract that is terminated under paragraph (1) or, as specified in paragraph (3), could have been terminated under paragraph (1) but for the prior completion of the contract's performance, the United States may, after notifying the contractor but pending the determination concerning exemplary damages referred to in paragraph (2), withhold from payments otherwise due to the contractor under any contract between the contractor and the military department or Defense Agency that entered into the terminated (or completed) contract an amount that is up to 10 times the cost incurred by the contractor in giving gratuities to the officer, official, or employee concerned, as such cost is estimated by the Secretary.

The existence of facts upon which the Secretary makes findings under ~~clause~~ paragraph (1) may be reviewed by any competent court.

(b) RETENTION OF DAMAGES; FRAUD FIGHTING FUNDS.—(1) Exemplary damages recovered under subsection (a)(2) may be retained by the Secretary of Defense, if recovered by a Defense Agency, or by the Secretary concerned, if recovered by a military department, without regard to section 3302 of title 31.

(2) The Secretary of Defense and the Secretaries of the military departments shall each establish a "Fraud-Fighting Fund" for use by the Defense Agencies, in the case of the fund established by the Secretary of Defense, or military department, in the case of a fund established by the Secretary concerned, which shall be available to provide funds, in addition to funds which may be otherwise available for activities including training, investigations, administrative proceedings, enforcement actions, and other related activities associated with deterring and preventing fraud. Exemplary damages recovered under subsection (a)(2) shall be paid into the appropriate fund and shall be available until expended.

(~~b~~c)(1) This section does not apply to a contract that is for an amount not greater than the simplified acquisition threshold (as defined in section 134 of title 41).

(2) Paragraph (4) of subsection (a) does not apply to a contract awarded on behalf of a military department or Defense Agency by a department or agency of the United States outside of the Department of Defense.

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§2410m. Retention of amounts collected from contractor during the pendency of contract dispute

(a) RETENTION OF FUNDS.—Notwithstanding sections 1552 (a) and 3302 (b) of title 31, any amount, including interest, collected from a contractor as a result of a claim made by a military department or Defense Agency under chapter 71 of title 41 or arising from an a recovery of exemplary damages under section 2207 of this title, shall remain available in accordance with this section to pay—

(1) any settlement of the claim by the parties;

(2) any judgment rendered in the contractor's favor on an appeal of the decision on that claim to the Armed Services Board of Contract Appeals under section 7104 (a) of title 41; ~~or~~

(3) any judgment rendered in the contractor's favor in an action on that claim in a court of the United States; or ~~.~~

(4) any determination under section 2207 of this title.

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