

Michigan Law Review

Volume 99 | Issue 3

2000

Prosecution of Minor Subcontractors Under the Major Fraud Act of 1988

Chris Liro
University of Michigan Law School

Follow this and additional works at: <https://repository.law.umich.edu/mlr>



Part of the [Criminal Law Commons](#)

Recommended Citation

Chris Liro, *Prosecution of Minor Subcontractors Under the Major Fraud Act of 1988*, 99 MICH. L. REV. 669 (2000).

Available at: <https://repository.law.umich.edu/mlr/vol99/iss3/4>

This Note is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.

NOTES

Prosecution of Minor Subcontractors Under the Major Fraud Act of 1988

Chris Liro

TABLE OF CONTENTS

INTRODUCTION	669
I. FIRST THINGS FIRST: THE STATUTE.....	672
A. <i>The Statutory Limit on Liability</i>	672
B. <i>The Statute as a Whole</i>	675
II. POLITICS AS USUAL: THE LEGISLATIVE HISTORY.....	678
A. <i>Congress Recognized This Very Problem</i>	679
B. <i>Amendments to House Bills 3500 and 3911</i>	682
C. <i>Ambiguity in the Senate Report</i>	684
III. POLICY IMPLICATIONS: WHY DO IT THE HARD WAY?	686
A. <i>Superiority of a Stand-Alone Statute</i>	686
B. <i>Equalization of Punishment</i>	690
CONCLUSION.....	694

INTRODUCTION

In the 'late 1980s, a series of well-publicized defense contractor abuses brought the ordinarily obscure topic of government contracting into the public eye.¹ These abuses included not only instances of seemingly wasteful charges, like the infamous \$600 toilet seat, approved by a complicit Department of Defense,² but also examples of truly fraudulent activity such as knowingly overbilling and supplying inferior quality goods.³ The fraud cases grabbed the public attention for three primary reasons. First, enormous sums of money were in-

1. See *Major Fraud Act of 1988: Hearings on H.R. 3500 and H.R. 3911 Before the Subcomm. on Crime of the House Comm. on the Judiciary*, 100th Cong. 100 (1987) [hereinafter *House Hearings*]; William S. Malarkey, *Government Contract Fraud*, 26 AM. CRIM. L. REV. 875, 875-76 (1989); David C. Morrison, *Pentagon Scandals Recur Despite Waves of Reform*, BALT. SUN, July 10, 1988, at 1E, referenced in *The Major Fraud Act, and the Government Fraud Law Enforcement Act of 1987: Hearings on H.R. 3911 and S. 1958 Before the Sen. Comm. on the Judiciary*, 100th Cong. 4 (1988) [hereinafter *Senate Hearings*].

2. See *House Hearings*, supra note 1, at 5; Edward Walsh, *President's Defense Appeal Finds Little Support on Hill Wary of Waste*, WASH. POST, Feb. 28, 1986, at A8.

3. See Charles P. Alexander, *Crime in the Suites*, TIME, June 10, 1985, at 56.

volved.⁴ Second, the nature of the fraud often posed a direct danger to United States troops, potentially compromising “national security.”⁵ Finally, large contractors, perceived as the perpetrators of the fraud, were apparently going unpunished.⁶

In response, Congress passed the Major Fraud Act of 1988 (“the Act”).⁷ Congress intended the Act to “provide federal prosecutors with an additional criminal statute targeting major procurement fraud committed against the United States.”⁸ As a general matter, prosecution under the Act is limited to “major fraud”: instances where the value of the contract exceeds \$1,000,000.⁹

A substantial portion of all federal government expenditures is paid to contractors. For example, the Defense Department alone spends more than \$200,000,000 annually on contractors, accounting for fourteen percent of all federal spending in 1997.¹⁰ As in the private sector, prime contractors — the party that has privity with the ultimate client, in this case the federal government — frequently enter into subcontracts. In those cases, subcontractors perform services or supply or manufacture goods for the government.

The role of the subcontractor includes a range of functions from supplying components to be included in a final product or providing some service to the prime contractor, to performing essentially the entire prime contract. In the latter case, the prime contractor’s role may

4. See Elizabeth Tucker, *Two Contractors Targeted in Defense Fraud Probe*, WASH. POST, Sept. 17, 1986, at D14 (discussing two cases involving losses suffered by the government on the order of \$100 million).

5. See Eric Pianin, *Faulty Parts Still Aboard Navy Ships; Sen. Nunn Calls Risk to Military Personnel ‘Outrageous’*, WASH. POST, Oct. 16, 1987, at A21.

6. See *House Hearings*, supra note 1, at 100 (“We have documented . . . quite a few examples of where we thought what I call some of the big boys got away.”); Kathleen Day, *Motorola to Plead Guilty to Fraud*, WASH. POST, Mar. 25, 1988, at A16 (discussing a plea bargain under which the contractor paid fines but no individuals were prosecuted and the company was not barred from future contracts). The defense industry’s dismissive attitude toward the issue also may have fueled the strong public and congressional reaction. See Sandra Sugawara, *Defense Probe Is Decried as A ‘Lynch Mob’: Aerospace Lobbyist Denies Rampant Fraud*, WASH. POST, Dec. 15, 1988, at D2.

7. Pub. L. No. 100-700, § 2(a), 102 Stat. 4631 (codified at 18 U.S.C. § 1031 (1994)). The Act was amended in 1989 to add provisions rewarding “whistle-blowers” financially. Major Fraud Act Amendments of 1989, Pub. L. No. 101-123, 103 Stat. 759. Not coincidentally, 1988 was also an election year. See Brian T. FitzPatrick, *Congressional Re-election Through Symbolic Politics: The Enhanced Banking Crime Penalties*, 32 AM. CRIM. L. REV. 1, 47 (1994).

8. S. REP. NO. 100-503, at 1 (1988), reprinted in 1988 U.S.C.C.A.N. 5969, 5969.

9. See 18 U.S.C. § 1031(a). The threshold was adopted, in part, to focus attention on large contractors who were not deterred by existing punishments. See H.R. REP. NO. 100-610, at 5 (1988).

10. *The Federal Page: Dividing Defense Dollars*, WASH. POST, Sept. 24, 1998, at A23.

be limited to taking a fee or a markup and conducting contract administration with the government.¹¹

In 1996, defendants Edwin and John Brooks and their company, B & D Electric, appealed convictions under the Act to the Fourth Circuit.¹² B & D Electric had fraudulently mislabeled and misrepresented the specifications of components supplied to two United States Navy prime contractors.¹³ Although both prime contracts were valued at more than \$1,000,000, B & D Electric's subcontracts were each valued at much less than the statutory threshold.¹⁴ Brooks contended on appeal that because B & D Electric's subcontracts did not exceed the \$1,000,000 threshold, he could not be prosecuted under the Act.¹⁵

The Fourth Circuit rejected Brooks's claim. In performing a detailed evaluation of the Act's language and legislative history, as well as policy concerns underlying the Act, the court held that the Act applied to cases where the prime contract, but not necessarily the specific subcontract, exceeded the \$1,000,000 threshold.¹⁶ The court believed that this interpretation would enable prosecutors to combat the fraud identified by Congress more effectively.¹⁷

The Fourth Circuit acknowledged that its holding conflicted with the conclusion reached by the Second Circuit.¹⁸ In *United States v. Nadi*,¹⁹ the Second Circuit concluded that the Act did not apply if the specific subcontract under which fraud was committed did not exceed \$1,000,000.²⁰ The *Nadi* court also addressed the statutory language and legislative history of the Act and the policy concerns underlying the Act in reaching this decision.²¹ Although the scopes of the analyses were similar, the two courts reached opposite conclusions.²²

11. See 8 JOHN COSGROVE MCBRIDE & THOMAS S. TOUHEY, GOVERNMENT CONTRACTS §§ 49.10-49.30 (2001).

12. *United States v. Brooks*, 111 F.3d 365 (4th Cir. 1997).

13. See *id.* at 368.

14. The values of the two prime contracts were \$9,000,000 and \$5,000,000; the values of B & D Electric's respective subcontracts were \$51,544 and \$1,470. *Id.* at 368.

15. *Id.* at 368.

16. *Id.* at 368-70.

17. *Id.* at 369-70.

18. *Id.* at 369.

19. 996 F.2d 548 (2d Cir.), *cert. denied*, 510 U.S. 933 (1993).

20. See *Nadi*, 996 F.2d at 551. Because the value of the subcontract involved in *Nadi* did exceed \$1,000,000, the conclusion was distinguished by the *Brooks* court, among other reasons, as dicta. *Brooks*, 111 F.3d at 369. The Second Circuit, however, did explicitly adopt the rule: "[A] reasonable reading of the statute, in light of the legislative history, requires that we adopt the rule . . . whereby the value of the contract is determined by looking to the specific contract upon which the fraud is based." *Id.*

21. *Id.* at 551-52. The Supreme Court of Connecticut also implicitly adopted the *Nadi* interpretation by assuming that the value of a procurement contract exceeded \$1,000,000

This Note adopts the Fourth Circuit's position and argues that courts should read the Act to impose liability on contractors and subcontractors when the value of the prime contract exceeds \$1,000,000, even if the subcontract itself is less than \$1,000,000. Part I of this Note examines the statute and concludes that both the specific text on liability and the statute taken as a whole support liability for "low-value"²³ subcontractors. Because the mere existence of the disagreement between the circuits suggests some ambiguity in the statute itself, Part II examines the legislative history of the Act. It concludes that Congress knew the Act would apply to low-value subcontractors and, more generally, was openly hostile to business groups' efforts to limit the scope of the Act. Part III discusses the benefits of judicial and prosecutorial clarity as well as the symbolic value of use of a statute specifically tailored to the crime of contract fraud, and counters arguments that prosecution of low-value subcontractors is unfair. The Note concludes that these arguments support prosecution of low-value subcontractors and accordingly recommends that courts adopt the Fourth Circuit's position when faced with this issue in the future.

I. FIRST THINGS FIRST: THE STATUTE

This Part examines the statute from two different perspectives — the specific text prescribing liability and the Act as a whole — and concludes that the Act extends to subcontractors and imposes liability when either the prime contract or the subcontract exceeds \$1,000,000.

A. *The Statutory Limit on Liability*

Statutory interpretation begins with the text of the statute,²⁴ and the text here should be read as imposing liability on low-value subcontractors. The statutory language prescribing liability reads:

Whoever knowingly executes . . . any scheme or artifice with the intent to defraud the United States . . . in any procurement of property or services

when holding that discharging an employee who resisted participation in the fraud violated public policy. See *Faulkner v. United Tech. Corp.*, 693 A.2d 293, 296 n.6 (Conn. 1997).

22. Compare *Brooks*, 111 F.3d at 368, with *Nadi*, 996 F.2d at 551; see also Major Wallace, *Federal Circuits Split on Application of the Major Fraud Act to Government Contracts*, ARMY LAW., Nov. 1997, at 41 (summarizing the development of the split). Since the split developed in 1997, the Third Circuit recognized the division but avoided the question. See *United States v. Sain*, 141 F.3d 463, 472 (3d Cir. 1998). This issue has not been addressed within the remaining circuit courts of appeal.

23. This Note will use the term "low-value" to refer to contracts or subcontracts under \$1,000,000. This Note assumes that the prime contract with the United States is valued at more than \$1,000,000 unless otherwise noted.

24. See *Landreth Timber Co. v. Landreth*, 471 U.S. 681, 685 (1985) ("It is axiomatic that '[t]he starting point in every case involving construction of a statute is the language itself.'" (alteration in original) (citation omitted)).

as a prime contractor with the United States or as a subcontractor or supplier on a contract with the United States, *if the value of the contract, subcontract, or any constituent part thereof, for such property or services is \$1,000,000 or more* shall . . . be fined . . . or imprisoned . . .²⁵

A simple reading of this language leads to the conclusion that any contractor, subcontractor, or supplier who commits fraud can be liable if any component of the contract exceeds \$1,000,000.²⁶ Because the statute reads “*any constituent part*,”²⁷ satisfaction of the dollar threshold need not be achieved through the fraudulent actor’s own contract.²⁸ Furthermore, the statute’s use of the word “or” within the list of parties who are potentially liable indicates an intent to include all such parties as potential defendants.

This reading of the statute also accords with the canon of interpretation requiring that the statute be interpreted so as to give effect to each word of the statute.²⁹ At first blush, one might argue that an interpretation that relies only on the value of the contract and ignores the subcontract reads out the term “subcontract” from the statutory language.³⁰ To say that any prime contract with a value over \$1,000,000 satisfies the threshold yet the value of the subcontract does not matter seems to leave the latter term meaningless.³¹ Accordingly, this argument suggests that, to comport with the canon of construction, low-value subcontractors should not be covered by the Act. The term “subcontract,” however, does have meaning when a subcontractor is awarded a subcontract valued at more than \$1,000,000 by a prime contractor who itself does not hold a \$1,000,000 contract directly with the government. As the court explained in *Brooks*:

[I]f a prime contractor had entered into three separate contracts, agreeing under each to supply the United States with \$750,000 worth of equipment, but entered into a single supply contract with a subcontractor for \$1 million worth of parts, the subcontractor would be covered by the Act.³²

25. 18 U.S.C. § 1031(a) (1994) (emphasis added).

26. See *United States v. Brooks*, 111 F.3d 365, 368-69 (4th Cir. 1997) (“From a straightforward reading of this statute . . . any contractor or supplier involved with a prime contract . . . is guilty so long as the prime contract, a subcontract, a supply agreement, or any constituent part of such a contract is valued at \$1 million or more.”).

27. 18 U.S.C. § 1031(a) (emphasis added).

28. See *Brooks*, 111 F.3d at 370.

29. E.g., *United States v. Nordic Village, Inc.*, 503 U.S. 30, 35 (1992); *United States v. Menasche*, 348 U.S. 528, 538-39 (1955) (“It is our duty ‘to give effect, if possible, to every clause and word of a statute . . .’” (citation omitted)).

30. The statute reads “if the value of the contract, subcontract, or any constituent part . . . is \$1,000,000 or more. . . .” 18 U.S.C. § 1031(a).

31. This follows from the seemingly reasonable, though incorrect, assumption that the value of the subcontract *must* always be less than that of the prime contract.

32. *Brooks*, 111 F.3d at 370.

Although perhaps unusual, the circumstances described by the *Brooks* court give effect to all the statute's language.³³

Although the Second Circuit found that the only relevant contract value was that of the contract under which the fraud occurred,³⁴ its interpretation depends on logic flawed by reliance on unpersuasive definitions of statutory terms. The primary basis for that court's interpretation was the conclusion that the phrase "if the value of the contract, subcontract, or any constituent part thereof" tracks the preceding phrase, which reads "as a prime contractor with the United States or as a subcontractor or supplier on a contract in which there is a prime contract. . . ."³⁵ In sum, the Second Circuit interpreted this language to mean that "where the prime contractor is accused of fraud, we look to the value of the prime contract, but where the subcontractor is accused of fraud we look to the value of the subcontract, and where the supplier is accused of fraud we look to the value of the related constituent part of the contract."³⁶ Closer examination, however, reveals that the two phrases should not be interpreted to have tracking, or parallel, structures.

The primary error in this interpretation is that it improperly assumes mutual exclusivity among the three terms in each series. In other words, the Second Circuit assumes that a contractor is not a subcontractor is not a supplier, and a contract is not a subcontract is not a "constituent part." The terms "supplier" and "constituent part," however, do not unambiguously exclude the other terms. Rather, both the general meaning and the trade usage of the language suggest that contractors, and certainly subcontractors, are "suppliers."³⁷ Similarly, a subcontract is not plainly distinct from a constituent part, and the inclusive interpretation of "constituent part" is further emphasized by

33. Moreover, the legislative history reveals that such circumstances are not merely a post hoc contrivance to give effect (artificially) to the language but rather were explicitly intended by Congress to be subject to the Act. *See infra* note 103 and accompanying text.

34. *United States v. Nadi*, 996 F.2d 548, 551 (2d Cir. 1993) ("[A] reasonable reading of the statute, in light of the legislative history, requires that we adopt the rule . . . whereby the value of the contract is determined by looking to the specific contract upon which the fraud is based.").

35. *See Nadi*, 996 F.2d at 551 (quoting 18 U.S.C. § 1031(a)).

36. *Id.*

37. *See MacEvoy Co. v. United States*, 322 U.S. 102, 108-11 (1944) (holding that the Miller Act does not define the terms subcontractor and supplier, and that the meaning of the terms must be found in the usage of the trade); *Graham, Van Leer & Elmore Co., Inc. v. Jones & Wood, Inc.*, 656 F. Supp. 667, 669 (D.D.C. 1987) (implying that the terms subcontractor and supplier are interchangeable in a common law contract case); *Technassociates, Inc. v. United States*, 14 Cl. Ct. 200, 205-206 (1988) (quoting Government Standard Form No. 1436, a settlement proposal, which states that "[t]he term 'subcontractors,' . . . includes suppliers").

the word “any.”³⁸ Most strikingly, no standard or trade definitions suggest correlation of a “constituent part” to a “supplier,” as is vital to the Second Circuit’s construction.³⁹

The loose and overlapping definitions of these terms fulfill the purpose of creating broad coverage of the law,⁴⁰ but are not compatible with an attempt to define precise, tracking definitions.⁴¹ Because the Second Circuit used flawed logic to determine that the contract-subcontract-component part series tracked the contractor-subcontractor-supplier series, other courts should not follow the resulting conclusion that only the subcontract value is dispositive with respect to subcontractor liability. Instead, courts should adopt the more straightforward reading of the Fourth Circuit, which follows the text by simply looking at the value of “any” part.

B. *The Statute as a Whole*

In addition to the specific text at issue, a broader examination of the statute supports the conclusion that the Act should apply to low-value subcontractors.⁴² This Section examines three issues concerning the larger contours of the statute: the magnitude of the fraud, the statute of limitations, and the target of the fraud. It concludes that these broader themes support application not only to prime contractors, but to low-value subcontractors as well.

The Act does not look to the magnitude of the fraud when establishing liability.⁴³ Rather, it looks to the value of a contract.⁴⁴ Thus, while a potential objection to the Fourth Circuit’s broad interpretation is that it is unfair to subcontractors because the magnitude of the fraud

38. 18 U.S.C. § 1031(a). See *Harrison v. PPG Industries, Inc.*, 446 U.S. 578, 587-89 (1980) (indicating the importance of the phrase “any other final action”).

39. See *Nadi*, 996 F.2d at 551 (“[W]here the supplier is accused of fraud we look to the value of the related constituent part of the contract.”).

40. See *infra* note 111 and accompanying text (discussing goal of an expansive statute).

41. Moreover, the legislative history reveals that Congress added these two clauses to the bill at two separate points in time by two different bodies, suggesting no intent that the phrases “tracked” as a matched pair. See H.R. 3911, 100th Cong. (1988) (adding the contract-subcontract-constituent part clause); 134 CONG. REC. 31569 (1988) (adding the contractor-subcontractor-supplier clause).

42. See *Richards v. United States*, 369 U.S. 1, 11 (1962) (holding that a particular statutory interpretation should be considered with respect to the larger goals and policies embodied in the statute); NORMAN J. SINGER, 2A STATUTES AND STATUTORY CONSTRUCTION § 46.05 (1992).

43. The magnitude of the fraud means the amount of money that the government loses as a result of the fraud. This amount would include the unjust enrichment enjoyed by the fraudulent actor, as well as costs associated with correcting the effects of the fraud. See *infra* note 153 and accompanying text.

44. 18 U.S.C. § 1031(a).

may be small,⁴⁵ on its face the Act applies to *all* prime contractors with \$1,000,000 contracts, regardless of the magnitude of the fraud.⁴⁶ Congress did require looking to the magnitude of the fraud in portions of the Act that address damages, showing that consideration of the magnitude is important in some instances.⁴⁷ The threshold question of liability, however, is not such an instance.⁴⁸ While applying the Act to cases where the size of the fraud is small may appear harsh, it is undisputed that the Act applies to prime contractors in such cases, and there is no justification to treat subcontractors differently.⁴⁹

The importance of the contract value rather than the fraud value is demonstrated by the facts of *United States v. Sain*.⁵⁰ In *Sain* the defendant committed fraud by using less expensive regenerated carbon in a water treatment plant constructed and operated for the Army after specifying that it would need to use more expensive virgin carbon.⁵¹ Supplying this carbon was not included in the original \$5,000,000 contract, and so was addressed in a series of three contract modifications, each for \$27,500, in which *Sain* charged the Army for virgin carbon.⁵² The Third Circuit held that, even though the component part (the modification) was less than \$1,000,000, the modifications did not stand alone but were incorporated elements of the prime contract; thus, the Act applied based on the value of the prime contract.⁵³ These facts parallel the subcontractor situation in which a low-value component part is attached to a prime contract.

Another aspect of the Act that supports its application to low-value subcontractors is the extended statute of limitations. The Act

45. See *United States v. Nadi*, 996 F.2d 548, 552 (2d Cir. 1993). Similar objections were raised in congressional hearings concerning the Act. See *infra* note 76 and accompanying text.

46. See 18 U.S.C. § 1031(a).

47. See 18 U.S.C. § 1031(b) (authorizing enhanced fines when “the gross loss to the Government or the gross gain to a defendant is \$500,000 or greater . . .”); 18 U.S.C. § 1031(d) (authorizing fines “up to twice the amount of the gross loss or gross gain involved in the offense . . .”).

48. See 18 U.S.C. § 1031(a).

49. As it turns out, application of the Act to instances of low-magnitude fraud is not so harsh after all because fines and sentences under the United States Sentencing Guidelines are proportional to the magnitude of the fraud. See *infra* Section III.B.

50. 141 F.3d 463 (3d Cir. 1998).

51. *Id.* at 468-69.

52. *Id.* at 466-68.

53. *Id.* at 472-73 (“[E]ven though *Sain* used the modifications to defraud the Army, the fraud intrinsically involved the approximately \$7 million contract.”). The Third Circuit did not pass judgment on the similar question of a subcontract between the prime contractor and a subcontractor rather than a modification between the prime contractor and the government. See *id.* at 472.

grants a seven-year statute of limitations for prosecutions,⁵⁴ and the rationale for an extended statutory period applies to fraud by subcontractors as well as by prime contractors. The longer statutory period differentiates the Act from other statutes that could be used to prosecute fraud,⁵⁵ such as the False Claims Act,⁵⁶ the False Statements Act,⁵⁷ and the federal anti-conspiracy statute,⁵⁸ all of which are subject to a five-year limitations period.⁵⁹ Congress extended the statutory period in response to perceived complexities of major fraud investigations.⁶⁰ Therefore, one might incorrectly assume that applying the Act to “simple” subcontractor cases might not be appropriate.

Investigating subcontractor fraud, however, may be just as complex as investigating prime contractor fraud. Low-dollar fraud may be easier to hide within the bulk of a large prime contract. Likewise, while large contractors typically have nominal institutional systems to detect fraud by their employees,⁶¹ fraud by small subcontractors may more often be instigated at the highest levels of the company.⁶²

Even if not all investigations are complex, Congress’s finding that *some* prosecutions require lengthy investigations does not mean that all prosecutions must be complex. The Act undisputedly applies to cases of prime contractors committing small frauds, whether difficult to discover or not. Again, there is no reason to create a special interpretation for subcontractors.

Moreover, fraud by both prime contractors and subcontractors hurts the intended beneficiary of the Act, the United States govern-

54. 18 U.S.C. § 1031(f) (1994). Indeed, the Act is often the last resort for prosecution when other counts have been time-barred. *See, e.g., Under Seal v. United States (In re Grand Jury Subpoena)*, 175 F.3d 332, 338 (1999) (“Because the statute of limitations had apparently run on a number of the potential criminal charges, the criminal investigation was focused solely on whether [the] conduct violated the Major Fraud Act . . .”).

55. *See House Hearings, supra* note 1, at 77.

56. 18 U.S.C. §§ 286, 287 (1994).

57. 18 U.S.C. § 1001 (1994).

58. *See* 18 U.S.C. § 371 (1994).

59. 18 U.S.C. § 3282 (1994) (specifying a five-year statute of limitations for all non-capital offenses unless otherwise specified).

60. The legislative history supports the conclusion that the statutory period was extended to accommodate complex investigations. *See House Hearings, supra* note 1, at 42.

61. *See UNITED STATES GENERAL ACCOUNTING OFFICE, DOD PROCUREMENT: USE AND ADMINISTRATION OF DOD’S VOLUNTARY DISCLOSURE PROGRAM 2* (1996) (noting that from 1986 to 1994, 138 contractors had detected and voluntarily disclosed potential fraud under a DOD program. These contractors represented 48 of the largest 100 contractors and 90 of the remaining approximately 32,000 contractors.).

62. *See, e.g., United States v. Brooks*, 111 F.3d 365 (4th Cir. 1997). Of course, upper-level management may be involved in the fraud at large firms also. *See Faulkner v. United Tech. Corp.*, 693 A.2d 293 (Conn. 1997) (employee fired for refusing to participate in fraudulent scheme).

ment.⁶³ Even if a subcontractor commits the fraudulent act, the loss induced is likely to fall eventually on the government via the prime contract. For example, in *United States v. Spring Works, Inc.*,⁶⁴ substandard springs provided by a subcontractor were used in helicopters, cruise missiles, fighter jets, and the space shuttle. The cost to the government to correct the problems was estimated to be over \$1,500,000.⁶⁵ The subcontract value, however, was reported to be only \$160.⁶⁶ The adverse effects to the United States are severe whether a prime contractor or subcontractor commits the fraud. By compromising the execution of a high-dollar-value contract, subcontractor fraud is equally “major” from the perspective of the United States.

II. POLITICS AS USUAL: THE LEGISLATIVE HISTORY

Although Part I demonstrates that the Act’s text standing alone supports application to low-value subcontractors, the existence of a split of authority suggests that the text may not completely resolve the question. In cases where the language itself is ambiguous, the Supreme Court has recognized the validity of seeking guidance from the legislative history.⁶⁷ From another perspective, legislative history manifests the intent of Congress.⁶⁸ Whether couched in terms of resolving ambi-

63. See 18 U.S.C. § 1031 (a)(1) (1994).

64. No. CR 86-1112-WMB (C.D. Cal. April 6, 1987) (sentencing memorandum), reprinted in *House Hearings*, *supra* note 1, at 170.

65. *House Hearings*, *supra* note 1, at 167.

66. *United States v. Brooks*, 111 F.3d 365, 369 (4th Cir. 1997).

67. *E.g.*, *Green v. Bock Laundry Machine Co.*, 490 U.S. 504, 508-09 (1981) (“We begin by considering the extent to which the text . . . answers the question before us. Concluding that the text is ambiguous . . . we then seek guidance from legislative history . . .”).

68. See, *e.g.*, *Ford Motor Credit Co. v. Cenance*, 452 U.S. 155, 158 n.3 (1981) (“Absent a clear indication of legislative intent to the contrary, the statutory language controls construction.”).

The modern trend is for courts to look to the statutory language above the intent of the legislature as indicated in legislative history to assess statutory meaning. See SINGER, *supra* note 42, § 48.02. Justice Scalia, in particular, strongly supports this view of interpretation:

The meaning of terms on the statute books ought to be determined, not on the basis of which meaning can be shown to have been understood by a larger handful of the Members of Congress; but rather on the basis of which meaning is (1) most in accord with the context and ordinary usage, and thus most likely to have been understood by the whole Congress which voted on the words of the statute . . . and (2) most compatible with the surrounding body of law

Green, 490 U.S. at 528 (Scalia, J., concurring).

Others have criticized this textualist approach, noting, for example, that textualists have neglected interpretative canons that promote individual liberty or executive authority while overusing rules that narrow statutory meaning as a means to promote federalism and states’ rights. See Brandorf C. Mank, *Textualism’s Selective Canons of Statutory Construction: Reinforcing Individual Liberties, Legislative Authority, and Deference to Executive Agencies*, 86 KY. L. J. 527, 528 (1998); see also Richard A. Posner, *Statutory Interpretation — In the Classroom and in the Courtroom*, 50 U. CHI. L. REV. 800, 822 (1983) (“I know of no principled, nonpolitical basis for a court to adopt the view that Congress is legislating too much

guity or finding intent, courts commonly use legislative history to resolve issues of statutory interpretation even though the practice is considered controversial by some academics, judges, and justices.⁶⁹

Part II of this Note examines the Act's legislative history and concludes that Congress intended the Act to apply to subcontractors with low-value subcontracts on major prime contracts. Section II.A demonstrates that, in drafting the Act, Congress specifically supported its application to low-value subcontractors. Section II.B asserts that amendments to the statutory language made in response to opponents' concerns did not change the underlying liability of subcontractors. Section II.C gives further attention to specific language in the legislative history that was interpreted differently by the Second and Fourth Circuits.

A. Congress Recognized This Very Problem

This section asserts that Congress anticipated the Act's application to low-value subcontractors and was hostile to those who would exempt such parties. Proceedings of the two House hearings conducted to debate the Act indicate Congress's desire to take a hard line on fraudulent actors. The Subcommittee on Crime of the House Judiciary Committee held an initial hearing on the Act in December 1987.⁷⁰ Witnesses at the December hearing included sponsors of the legislation, government prosecutors, government auditors, and public

and ought therefore to be reined in by having its statutes construed strictly. I add now that such a view would be a form of judicial activism because it would cut down on the power of the legislative branch; and at this moment in history, we do not need more judicial activism.”).

Whether legislative history is consulted to “resolve ambiguity” or to assess “intent” may be a purely semantic distinction, for, after all, ambiguity can almost always be found if one looks hard enough. *Cf. Pacific Gas and Elec. Co. v. G.W. Thomas Drayage & Rigging Co.*, 442 P.2d 641, 643 (Cal. 1968) (finding the belief of perfect verbal expression to be a “remnant of a primitive faith” and allowing introduction of extrinsic, parol evidence in an expansive set of contract disputes). This parallel between use of parol evidence and legislative history, and the trend to weaken the parol evidence rule in contract cases, have been used to argue for greater use of legislative history by courts interpreting statutes. *See* Stephen F. Ross & Daniel Tranen, *The Modern Parol Evidence Rule and Its Implications for New Textualist Statutory Interpretation*, 87 GEO. L.J. 195, 199 (1998).

69. *See* Jane S. Schacter, *The Confounding Common Law Originalism in Recent Supreme Court Statutory Interpretation: Implications for the Legislative History Debate and Beyond*, 51 STAN. L. REV. 1, 15 (1998) (reporting the findings of an empirical study showing that the Supreme Court invoked legislative history in nearly fifty percent of the statutory interpretation cases in 1996). Similarly, a Westlaw search conducted by the author discovered that the United States Courts of Appeals had cited to the United States Code Congressional and Administrative News (U.S.C.C.A.N.) in 340 decisions in 2000.

70. *See House Hearings*, *supra* note 1, at 1.

“watchdog” interest groups.⁷¹ Every witness took a hard line against the contracting industry.⁷²

The Subcommittee held a second hearing in March 1988 to provide an opportunity for opponents of the measure to air their views.⁷³ Representative William Hughes, the sponsor of the bill, greeted these witnesses by recalling that the December hearing “documented a story of greed, malfeasance and fraud in procurement law that is unacceptable,”⁷⁴ including cases that “can most directly cost Americans their lives.”⁷⁵

During the March hearing, opponents of the Act objected to potential harms to small businesses created by the Act’s use of contract values to trigger application. The U.S. Chamber of Commerce asserted that the Act “would penalize small businesses in ways that are both illogical and overwhelming.”⁷⁶ The Chamber pointed to the “illogical” exposure of small businesses acting as subcontractors,⁷⁷ the

71. *See id.* at III.

72. *See generally id.* at 5-6, 149. The subcommittee chairman and sponsor of the bill, William Hughes, set the tone with his opening remarks: “In today’s hearing, we will discuss a disturbing trend of successive scandals in procurements for spare parts, overhead charges, malfunctioning equipment and various other fraudulent schemes that bilk the American taxpayers of billions of dollars and at the same time diminish their confidence in the Executive Branch’s ability to efficiently administer essential government functions.” *Id.* at 5.

Similarly: “Simply put, when major fraud occurs, you need a major tool to combat it.” *Id.* at 9 (testimony of Sen. Grassley). “We also welcome legislation which will enhance our prosecutive efforts and protect the government against those who would cheat or mislead it. . . .” *Id.* at 34 (testimony of John Keeney, Deputy Assistant Attorney General). “H.R. 3500 is a major effort which we welcome in support of our mission of detecting and investigating fraud, waste and abuse within the postal service.” *Id.* at 43 (testimony of Donald Davis, U.S. Postal & Inspection Service). “I share the concern of you and our fellow taxpayers about white collar crime in the government contracting environment and, consequently, welcome any efforts to prevent it or impose stiff penalties on the perpetrators.” *Id.* at 89 (testimony of Fred Newton, Defense Contract Audit Agency). “[S]o I hope that the committee efforts beyond this bill . . . is the kind of thing where . . . you lead the charge in saying to the Department of Justice we want to know why these large defense contractors got away with this.” *Id.* at 102 (testimony of Dina Rasor, Project on Military Procurement).

73. *See id.* at III, 149-50. Witnesses included representatives of the United States Chamber of Commerce, the Electronic Industries Association, and the Professional Services Council.

74. *Id.* at 149.

75. *Id.*

76. *Id.* at 205 (prepared comments of the United States Chamber of Commerce).

77. *Id.* (“For example, a small construction firm could be paving a driveway for a large government office building. The subcontract could be less than \$10,000 out of a \$20 million contract for that building. If it is guilty of mischarging \$1,000 on its work, it could be liable for a \$40 million fine.”). A similar scenario was raised by the Professional Services Council. *See id.* at 285 (“Thus, a subcontractor providing \$50,000 in services under a \$5 million prime contract could be ordered to pay as much as \$10 million on a timesheet overcharge of \$1,000.”). At the time, the bill did not include a limit on fines. *See* H.R. 3911, 100th Cong. (1988). The Act as enacted does include an upper limit of \$10,000,000. *See* 18 U.S.C. § 1031(c) (1994). Moreover, fines are made proportional to the magnitude of the fraud under the U.S. Sentencing Guidelines. *See infra* Section III.B.

very issue of disagreement between the Second and Fourth Circuits addressed by this Note. As a general matter, the opponents of the Act wanted to tie application, sentences, and penalties, for both prime contractors as well as subcontractors, to the magnitude of the fraud rather than the contract size.⁷⁸ The opponents also asserted that (1) prosecution should require a showing of knowing and willful intent,⁷⁹ (2) the Act would devastate small businesses,⁸⁰ and (3) above all, the Act simply was not needed.⁸¹

The Committee did not receive the opponents' testimony kindly,⁸² and its response demonstrates that it foresaw the possible prosecution of low-value subcontractors. The chairman specifically challenged the worst-case example posed by the Chamber of Commerce: "First, let me just ask you, Mr. Kipps, do you believe the Department of Justice would prosecute a subcontractor for a \$1,000 mischarge on a \$10,000 subcontract on a \$20 million contract and ask for a \$40 million fine?"⁸³ In other words, the Committee, at least, understood that the government *could* prosecute under the Act in such circumstances. Any decision to prosecute would be discretionary rather than limited by statute.⁸⁴ While the magnitude of the fine or sentence, or even the likelihood of prosecution, might have been in question, the applicability of the Act was not.

This direct and specific confrontation of the issue, moreover, should supersede any broad statement that could suggest a more narrow reading of the Act.⁸⁵ One example of such a broad statement is contained in the Senate report, which states that the Act "would apply

78. *See House Hearings, supra* note 1, at 191-94 (statement of Clarence Kipps).

79. *See id.* at 192.

80. *See id.* at 281 (statement of Christopher Cross) ("I would also like to add that we believe that H.R. 3911 would serve as a deterrent not to fraud, but to entrepreneurship of small businesses.").

81. *See id.* at 192.

82. *See id.* at 295 (comments of Rep. Smith) ("Gentlemen, I am sorry that you cannot be sitting where we are in a way so that you could have heard yourselves. It is disheartening to hear testimony like this . . ."); *House Hearings, supra* note 1, at 311 (comments of Rep. Hughes) ("I have not heard any constructive suggestions. I have only heard criticisms of each section of the bill, without fail."); *see also* H.R. REP. NO. 100-610, at 3 (1988).

83. *House Hearings, supra* note 1, at 312. Mr. Kipps, representing the United States Chamber of Commerce, stated that he did not think that it would, but feared that prosecutors would abusively leverage the possibility during plea bargain negotiations. Representative Hughes responded that existing statutes also gave prosecutors the potential to wreak havoc with a corporation and challenged Mr. Kipps to provide examples of instances when the Justice Department had abused the process. *Id.*

84. The potential for arbitrary results stemming from prosecutorial discretion is mitigated by the equalizing effects of the U.S. Sentencing Guidelines. *See infra* Section III.B.

85. *See Square D Co. v. Niagra Frontier Tariff Bureau*, 476 U.S. 409, 420 (1986) ("Petitioners have pointed to no specific statutory provision or legislative history indicating a specific congressional intention to overturn the . . . construction; harmony with the general legislative purpose is inadequate for that formidable task." (citation omitted)).

to fraud committed in connection with a contract, or subcontract or any part of a contract or subcontract . . . worth at least \$1 Million.”⁸⁶ Further, Representative McCollum indicated in the House debate that some limits exist within the Act: “We are talking now about procurement contracts of \$1 Million or more, very visible contracts, not the really tiny contracts with the Government.”⁸⁷ Unlike the hearing debate, these examples address neither the application of the Act to a subcontractor as opposed to a prime contractor nor the particular issue of low-value subcontractor liability. Given the relative lack of specificity, these passages should be considered less persuasive.

B. *Amendments to House Bills 3500 and 3911*

Amendments made to the Act to protect small companies do not extend relief to low-value subcontractors because the amendments address penalties rather than liabilities and do not distinguish between prime and subcontractors. This Section examines amendments made to the bill’s language during its passage.⁸⁸ These amendments demonstrate that rather than limit application to subcontractors, Congress made last-minute modifications that resulted in *greater* application to subcontractors than what previously existed.

The earliest amendments to the bill demonstrate the House’s desire to expand, rather than limit, the effects of the Act and to tie liability to the contract value. These amendments lowered the standard of proof and increased the maximum possible fine. Specifically, House Bill 3911, introduced in February 1988, removed the need to prove specific intent,⁸⁹ and also allowed the alternate fine to be “based upon

86. S. REP. NO. 100-503, at 3 (1988), *reprinted in* 1988 U.S.C.C.A.N. 5969, 5970; *see also* *United States v. Nadi*, 996 F.2d 548, 551-52 (2d Cir. 1993). Similarly, House Bill 3500, the original bill, was introduced in 1987 to apply “in situations involving \$1,000,000 or more.” 133 CONG. REC. 27988 (1987).

87. 134 CONG. REC. 10328 (1988). He continued by stating that conditions were placed in the bill “to protect the small businessman to make sure what we were dealing [with] . . . is truly major fraud The objective here is not to bankrupt small companies” 134 CONG. REC. 10328 (1988).

88. For detailed information about these amendments, see H.R. 3911, 100th Cong. (1988). The House Bill 3911 documentation tracks a number of edits and subsequent re-reportings. Where available, references have been made to House Report 610, which explains the amendments simply.

Representative William Hughes first introduced legislation that became the Act as House Bill 3500 on October 15, 1987. H.R. REP. NO. 100-610, at 2 (1988). On February 3, 1988, the House Subcommittee on Crime amended House Bill 3500, and the modified version was reported to the full committee as a clean bill (House Bill 3911) on February 4, 1988. *See* H.R. REP. NO. 100-610, at 5.

89. This was accomplished by replacing the previous language, taken from the Mail Fraud Act, 18 U.S.C. § 1341 (1994), with language from the Bank Fraud Act, 18 U.S.C. § 1344 (1994), as had been requested by the Defense and Justice Departments. *See* H.R. REP. NO. 100-610, at 5; *see also* *House Hearings*, *supra* note 1, at 39, 77.

double the 'value of the contract' rather than the 'object of the fraud.'⁹⁰

While other amendments made in April 1988 did provide relief to both contractors and subcontractors, they affected only the extent of damages, not subcontractor liability.⁹¹ The first significant amendment changed the maximum alternate fine under the bill from double the value of the contract to \$10,000,000.⁹² The second "relief" amendment limited the situations under which the "whistleblower" reward could be granted.⁹³ These provisions, especially the cap and limitations on the fine, do give relief to small businesses and are consistent with the recommendations of business interests.⁹⁴ These amendments, however, do not distinguish between contractors and subcontractors. Nor did Representative McCollum's comment that the Act's objective was not to bankrupt small businesses⁹⁵ suggest that he was more concerned about subcontractors than prime contractors.⁹⁶ More importantly, the provisions address penalties but not liability.

Further amendments made by the Senate specifically recognized that the Act applied to subcontractors but did not distinguish between the liabilities of prime contractors and subcontractors.⁹⁷ First, the Sen-

90. H.R. REP. NO. 100-610, at 5.

91. *See id.* at 6. These modifications were based on additional testimony and comments, including that of House Bill 3911's opponents at the March 1988 hearing. *See supra* note 73 and accompanying text. Other amendments made at this time further strengthened the bill. In particular, one increased the maximum incarceration allowed under the bill from seven years to ten years and provided for a mandatory minimum sentence of two years if the offense involved a foreseeable and substantial risk of personal injury. *See* H.R. REP. NO. 100-610, at 6. This provision was added in response to examples of product substitution fraud where, for example, inferior parachute cord was supplied by a contractor. *See* 134 CONG. REC. 10327 (1988). The potential for direct bodily harm distinguishes many examples of defense contractor fraud from the typical white-collar crime scenario.

92. *See* H.R. REP. NO. 100-610, at 6. This amendment did address what the bill's opponents thought of as an unfair *magnitude* of penalty in their worst-case examples. *See supra* note 77 and accompanying text. The amendment further limited the alternate fine provision as applicable only when the amount of the fraud exceeded \$250,000 or when the fraud involved a substantial risk of personal injury. *See* H.R. 3911, 100th Cong. (1988).

93. *See* H.R. REP. NO. 100-610, at 6. The amendment excluded individuals who participated in the fraud and those who could have, but failed to prevent the fraud by informing the employer. The "whistleblower" protection provision was added with the introduction of House Bill 3911 and was modeled on similar provisions of the False Claims Act. *See id.* at 5.

94. *See House Hearings, supra* note 1, at 292-93. Moreover, the two limitations on when the fine may be implemented appear to be the basis for Representative McCollum's statement that conditions were placed in the bill to "protect the small businessman." *See* 134 CONG. REC. 10328 (1988).

95. *See supra* note 87 and accompanying text.

96. In fact, Representative McCollum is discussing "really tiny contracts *with the Government*." 134 CONG. REC. 10328 (emphasis added). In other words, he is discussing *prime* contracts, not subcontracts.

97. *See generally* H.R. 3911, 100th Cong. (1988). The bill was referred to the Senate after passing the full House by a vote of 419 to 0. *See* S. REP. NO. 100-503, at 2 (1988), *reprinted in* 1988 U.S.C.C. A.N. 5969, 5970.

ate Judiciary Committee modified the dollar threshold language from “if the value of the contract for such property or services is \$1,000,000 or more”⁹⁸ to “if the value of the contract, subcontract, or any constituent part thereof, for such property or services is \$1,000,000 or more.”⁹⁹ Later, the full Senate further clarified application to subcontractors by adding an explicit reference: the language “in any procurement . . . for the Government” was amended to read “in any procurement . . . as a prime contractor with the United States or as a subcontractor or supplier on a contract in which there is a prime contract with the United States.”¹⁰⁰ While other changes made by the Senate dull the teeth of the bill, the changes did not address the primary liability issue and gave no additional protection to low-value subcontractors.¹⁰¹

C. *Ambiguity in the Senate Report*

Perhaps the most striking aspect of the disagreement between the Second and Fourth Circuits is the opposite interpretations of the same sentence of the Senate Report for the Act.¹⁰² The sentence is contained in a passage attempting to clarify the meaning of the phrase “value of the contract.” The Senate Report states:

Section 1031(a) applies to procurement fraud “if the value of the contract, subcontract, or any constituent part thereof . . . is \$1,000,000 or more.” The phrase “value of the contract” refers to the value of the contract award, or the amount the government has agreed to pay to the provider of services whether or not this sum represents a profit to the contracting company. Furthermore, a subcontractor awarded a subcontract valued at \$1,000,000 or more is covered by this section, regardless of the

98. See H.R. 3911, 100th Cong. The text under debate in the House hearings, therefore, did not even mention subcontractors. Nevertheless, both supporters and opponents of the bill assumed that the bill covered subcontractors.

99. *Id.* What this phrase means and its explanation in Senate Report 503 are items of fundamental disagreement between the Second and Fourth Circuits. See *infra* Section II.C.

100. See 134 CONG. REC. 31569 (1988). The Second Circuit’s reading of the statute that the “contractor . . . subcontractor” phrase should “track” the “contract . . . subcontract” phrase, see *supra* notes 35-36 and accompanying text, is further weakened because the two phrases were added at two different times by two different groups.

101. For example, one change reduced the maximum fine under the bill from \$10,000,000 to \$5,000,000. See H.R. 3911, 100th Cong. Similarly, another change required that the amount of any fine be proportional to the offense, and a third established a maximum fine of \$10,000,000 for multiple-count prosecutions. See *id.* These changes affected the penalty magnitude, but not the reach, of the bill. The Senate limited the scope only by further extending Representative McCollum’s limitations to the alternate fine. Specifically, the amount-of-the-fraud threshold was increased from \$250,000 to \$500,000, and the endangerment threshold was changed from a “foreseeable and substantial risk” to a “conscious or reckless risk” standard. See *id.*

102. See *United States v. Brooks*, 111 F.3d 365, 370 (4th Cir. 1997); *United States v. Nadi*, 996 F.2d 548, 551 (2d Cir. 1993).

amount of the contract award to the contractor or other subcontractors.¹⁰³

The Fourth Circuit concluded that the "Senate report explanation supports the interpretation that the statute applies to the entire procurement effort where any contractual component has a value of \$1 million or more."¹⁰⁴ On the other hand, the Second Circuit read the same language and concluded that "the committee instructs that, in the case of a subcontractor, the value of the subcontract is controlling and not the value of the prime contract or other subcontract. . . ."¹⁰⁵

The Second Circuit interpretation, however, is unsupported by the legislative history as a whole and, accordingly, should not be followed.¹⁰⁶ Even before the Senate added specific subcontractor language to the bill, both proponents and opponents assumed low-value subcontractors would be covered.¹⁰⁷ The legislative history is also replete with examples where small subcontractors are the fraudulent actors.¹⁰⁸ Congress specifically focused on small subcontractor cases such as *Spring Works*: "While these criminal schemes are often life threatening and can have a disastrous effect on the ability of our troops to complete their mission, we have not received a significant sentence on most of these cases."¹⁰⁹

The Senate Report's language that a \$1,000,000 subcontract triggers application of the Act regardless of the value of a particular prime contract is meant to clarify the Act's application to subcontractors that might be exempted if *only* the value of the prime contract was considered.¹¹⁰ The record does not suggest that the report even considered the question of which agreement is "controlling" to be relevant. The report says merely that the subcontract value is *adequate* for application, but the Second Circuit's inference of *necessity* is not

103. S. REP. NO. 100-503, at 12 (1988), reprinted in 1988 U.S.C.C.A.N. 5969, 5975-76.

104. *Brooks*, 111 F.3d at 370.

105. *Nadi*, 996 F.2d at 551. The Second Circuit continues: "The committee . . . apparently had in mind situations where an individual subcontract is of greater value than the prime contract. We may infer from this that, where the subcontract is of lesser value than the contract, the value of the subcontract is also controlling." *Id.* at 551.

106. See *Simon v. Commissioner*, 68 F.3d 41, 46 (2d Cir. 1995) ("In light of the overriding legislative intent . . . we cannot employ two sentences in a legislative report to trump statutory language and a clearly stated legislative purpose.").

107. See *supra* notes 83-84 and accompanying text.

108. See *House Hearings, supra* note 1, at 167 (listing cases). The *Spring Works* case provides a compelling example. In that case, the subcontract value was reported to be only \$160, see *Brooks*, 111 F.3d at 369, yet the cost to the government exceeded \$1,500,000 and failure of the standard parts could have caused a loss of life. See *United States v. Spring Works, Inc.*, No. CR 86-1112-WMB (C.D. Cal. April 6, 1987) (sentencing memorandum), reprinted in *House Hearings, supra* note 1, at 175.

109. *Senate Hearings, supra* note 1, at 43.

110. See *supra* note 28 and accompanying text.

supported by the report. Moreover, reading the Senate's comment to *narrow* application of the Act is grossly inconsistent with the overall intent of Congress to develop an expansive, stand-alone statute to address cases of contract fraud committed against the United States.¹¹¹

Correctly, the Fourth Circuit's interpretation that the statute applies when the value of any contractual component exceeds \$1,000,000¹¹² is consistent with the Act's entire legislative history.¹¹³ The Fourth Circuit did not rely on an inference, but simply took the report at face value. Accordingly, this interpretation should be followed by other courts in the future.

III. POLICY IMPLICATIONS: WHY DO IT THE HARD WAY?

This Part argues that prosecution of low-value subcontractors under the Act is desirable because it facilitates fair and efficient prosecutions that send a clear symbolic message. Section III.A demonstrates that use of a statute that has been narrowly tailored toward fraud by government contractors is preferable because its use is more straightforward and efficient than are other potential means of prosecution, even if some redundancy exists. Moreover, as argued in Section III.B, equalization of penalties caused by the U.S. Sentencing Guidelines negates arguments that the Act should not apply to subcontractors because of severe and disproportionate punishments.

A. *Superiority of a Stand-Alone Statute*

Use of the Act in this context is desirable because of benefits inherent in a narrowly tailored statute. Specifically, application of the Act enables straightforward and efficient prosecutions and allows utilization of a statute that has been tailored toward fraud in a contract setting.¹¹⁴

Congress recognized these benefits during the legislative development of the Act. During Senate hearings, the Justice Department identified the creation of a general fraud crime as, in itself, reason to support the Act.¹¹⁵ The Department pointed to the benefits of a similar

111. See S. REP. NO. 100-503, at 11-12 (1988), *reprinted in* 1988 U.S.C.C.A.N. 5969, 5975-76. Had narrowing liability been the goal, the Senate might have said "a subcontractor . . . is covered . . . only . . ." Instead, the report uses the expansive language "a subcontractor . . . is covered . . . regardless . . ."

112. See *Brooks*, 111 F.3d at 370.

113. See Sections II.A and II.B.

114. See Richard A. Posner, *Economics, Politics, and the Reading of Statutes and the Constitution*, 49 U. CHI. L. REV. 203, 280-81 (1982) (discussing efficiency concerns in the interpretation of criminal statutes).

115. See *Senate Hearings*, *supra* note 1, at 60 ("There are really five significant provisions in this piece of legislation . . . The first is the creation of the general fraud crime in the

stand-alone statute, the Bank Fraud Act, passed in 1984.¹¹⁶ The Department asserted that the Bank Fraud Act had “facilitated and simplified the prosecution of hundreds of cases throughout the country.”¹¹⁷ Based on this observation, the Department recommended that Congress consider enacting the general fraud provision of the Act as a stand-alone felony and that the \$1,000,000 contract threshold apply as a trigger not for prosecution but for enhanced penalties.¹¹⁸

Members of Congress also recognized these benefits. Indeed, creation of a free-standing statute was identified as one of the main purposes of the Act.¹¹⁹ Representative Hughes noted, “At the present time . . . [w]e have to shop around. Can we put it within mail fraud? Can we put in within wire fraud? . . . We have no free-standing fraud statute as such.”¹²⁰ Similar motivation and desire for a stand-alone statute were evidenced when Congress passed the earlier Bank Fraud Act.¹²¹

The primacy of laws targeting specific, as opposed to general, kinds of criminal activity is also reflected in courts’ interpretations of conflicting statutes. The Supreme Court has concluded that a specific policy embodied in a later statute should control over an older, more general statute.¹²² Similarly, a canon of statutory construction dictates that, wherever a conflict exists, the more specific law should prevail over the more general.¹²³ While these holdings deal with cases of conflict, the logic reflects the conclusion that the law that more precisely addresses the issue better reflects legislative policy than does a law that is merely peripheral.

procurement process. This idea is very similar to what we had in the bank fraud area several years ago when we came here asking for help . . .”) (statement of Deputy Assistant Attorney General Victoria Toensing). This basis for support was not as prominent during the earlier House hearings, perhaps because the effects of the Sentencing Guidelines were less understood at that time.

116. *See id.*

117. *Id.* at 65.

118. *See id.* at 70.

119. *See House Hearings, supra* note 1, at 311 (statement of Rep. Hughes) (“One of the criticisms leveled by the panel of H.R. 3911 is that it will not increase the number of fraud cases. It is not the purpose, really, of this bill to do that. The purpose is to deter. And in the second place, to provide a freestanding statute that will cover acts of fraud against the United States Government . . .”).

120. *See id.* at 300.

121. *See S. REP. NO. 98-225*, at 377-78 (1984), *reprinted in* 1984 U.S.C.C.A.N. 3182, 3517-19 (“This approach of prosecuting bank fraud under statutes not specifically designed to reach this criminal conduct is necessarily problematic.”).

122. *See United States v. Estate of Romani*, 523 U.S. 517, 530 (1998).

123. *See, e.g., Security Pac. Nat’l Bank v. Resolution Trust Corp.*, 63 F.3d 900, 904 (9th Cir. 1995) (“Generally a more specific provision of an enactment prevails [over], in the sense of making an exception to, a more general provision.”).

Moreover, Congress passed the Act also to send a symbolic message of no tolerance for fraud against the government, even if the Act was redundant with pre-existing statutes. One argument that could be made against applying the Act to low-value subcontractors is that other statutes could also be used to punish wrongdoers. This argument applies indiscriminately to both prime contractors and subcontractors, and the mere existence of alternative statutes that could serve as the basis of prosecution does not mean that the Act should not apply.

The scope of the Act concededly does overlap with other criminal statutes. Prior to passage of the Act, contract fraud against the United States was typically prosecuted under a variety of more general statutes.¹²⁴ These include the False Claims Act,¹²⁵ the False Statements Act,¹²⁶ and statutes against conspiracy to defraud.¹²⁷ Similarly, the Mail Fraud¹²⁸ and Wire Fraud¹²⁹ statutes were sometimes used to reach cases where the mail or telephone was used to execute the fraud.¹³⁰ Finally, state fraud statutes could also be used as a means of prosecution.¹³¹

One might incorrectly conclude, then, that use of the Act in cases of low-value subcontractors is not appropriate or necessary to prosecute the wrongdoers.¹³² Opponents of the Act argued that it should not

124. See *House Hearings*, *supra* note 1, at 77.

125. 18 U.S.C. §§ 286-287 (1994).

126. 18 U.S.C. § 1001 (1994).

127. 18 U.S.C. § 371 (1994).

128. 18 U.S.C. §§ 1341-1342 (1994).

129. 18 U.S.C. § 1343 (1994).

130. Noncriminal means are also available to address fraud. In 1986, Congress passed the False Claims Amendment Act of 1986, Pub. L. No. 99-562, 100 Stat. 3153 (codified at 31 U.S.C. § 3701 (1994)), and the Program Fraud Civil Remedies Act of 1986, Pub. L. No. 99-509, 100 Stat. 1874 (codified at 31 U.S.C. § 3801 (1994)), to strengthen civil deterrents. These provisions raised civil and criminal penalties for violations involving fraud and false claims, provided protection for "whistleblowers," and strengthened provisions relating to *qui tam* suits involving government fraud. See *Senate Hearings*, *supra* note 1, at 10; *House Hearings*, *supra* note 1, at 9, 10, 192. Moreover, independent of judicial sanctions, government contractors can be debarred from future contracts. See *House Hearings*, *supra* note 1, at 126-30.

131. See, e.g., TEX. PENAL CODE ANN. § 32 (Vernon 1994); MICH. COMP. LAWS § 750.280 (1991) (specifying penalties for any person convicted of "any gross fraud or cheat at common law"). While opponents of the Act did look to the availability of alternative federal statutes, the presence of state criminal statutes was not invoked during committee testimony. As a general matter, a federal issue would seem to be involved when the federal government is the target of the crime and the appropriateness of federal legislation was not debated.

132. The court in *United States v. Brooks* did believe that the Act was necessary to effectively reach such parties:

We believe that our reading of the statute is no more anomalous than one which allows small subcontractors to escape prosecution under the provision . . . simply by ensuring that their own subcontract stays below the . . . jurisdictional amount. The *Nadi* court's interpretation could significantly undermine the purpose of the statute because pervasive fraud on a multi-million dollar defense project would be unreachable under the statute . . . if it were perpetrated in multiple separate subcontracts . . .

be passed because it offered nothing new: “Where is the evidence that [other] legislation has not done the job? In light of all this recent legislation, we believe further activity in this area to be unnecessary, redundant and — in fact — counterproductive.”¹³³ Even while strongly supporting passage of the Act in 1988, the Justice Department admitted that “[g]enerally, we have not encountered situations where conduct relating to fraud against the United States does not fall within the prohibitions of one or more of the [other] statutes.”¹³⁴

Possible redundancy or lack of necessity, however, does not invalidate application if the language and history indicate that the Act does apply.¹³⁵ While arguing the benefits of a stand-alone statute, the Justice Department cited the Bank Fraud Act,¹³⁶ which was passed by Congress in 1984 even though “[t]he great majority of cases of bank fraud we encountered were cognizable under [the] old statutes”¹³⁷ Even if the statute is largely — or solely — a symbolic means of focusing attention on a particular type of crime, its symbolic function does not undermine its force as law.¹³⁸

Moreover, although other means of prosecution are available, this redundancy applies to both low-value and high-value contractors. In other words, the Act undeniably applies to large prime contractors despite the existence of these same alternative means of prosecution. Although large prime contractors may be comparatively harder to punish and deter than smaller subcontractors,¹³⁹ that distinction alone cannot remove subcontractors from the scope of liability.

111 F.3d 365, 369 (4th Cir. 1997).

133. *House Hearings*, *supra* note 1, at 284-85; *see also id.* at 384-85.

134. *Id.* at 34.

135. *See Connecticut Nat'l. Bank v. Germain*, 503 U.S. 249, 253 (1992) (“Redundancies across statutes are not unusual events in drafting . . .”).

136. 18 U.S.C. § 1344 (1994).

137. *Senate Hearings*, *supra* note 1, at 65.

138. *See Mark Tushnet & Larry Yackle, Symbolic Statutes and Real Laws: The Pathologies of the Antiterrorism and Effective Death Penalty Act and the Prison Litigation Reform Act*, 47 DUKE L.J. 1, 84-85 (1997) (discussing a category of laws they call “symbolic statutes” that are not truly instrumental but rather express who we are as a society).

139. Large contractors do have greater political and economic power than do low-value subcontractors. Representative Hughes stated in testimony before the Senate Judiciary Committee that the ongoing procurement scandal in 1988 “suggests . . . that our current Federal statutes are not providing a sufficient deterrent.” *Senate Hearings*, *supra* note 1, at 25. Hughes and other members of Congress reached this conclusion based on findings that many large contractors simply had too much power to be punished adequately under the existing law. *See House Hearings*, *supra* note 1, at 100. Similarly, because the biggest contractors hold such a large share of the market, deterrence through debarment may not be effective. *See id.* at 130. Representative Hughes remarked, “I find that the small contractors are being dealt with very harshly but the larger ones are basically being restored. General Dynamics is a good example since they were restored within five months.” *Id.*

These arguments of redundancy and lack of necessity were raised by opponents to the Act before its passage, and were simply rejected by Congress. Regardless of the sympathy that smaller businesses tend to attract, even those that are fraudulent actors, the rationale supporting a stand-alone statute is just as strong when applied to subcontractors as to any other fraudulent actor.

B. *Equalization of Punishment*

Arguments that the Act should not be applied to low-value subcontractors because the magnitude of the penalty will be unfair also are not persuasive. Although Congress intended the Act to carry heightened penalties, the subsequent enactment of the Federal Sentencing Guidelines creates punishments that are, by design, proportional to the magnitude of the offense.¹⁴⁰

Although the language and history of the Act direct that it should be applied to cases of low-value subcontractor fraud, some courts may still consider prosecution to be unfair.¹⁴¹ Similarly, some courts may be hesitant to allow prosecution under the Act if the penalty is perceived to lack proportion to the offense.¹⁴² This perspective stems from the observation that a mode of punishment necessary to deter large corporations and contractors may not be necessary, and thus is not appropriate, with respect to small businesses. Congress passed the Act as a means to reach wrongdoers who may not have been adequately deterred by the pre-existing penalties,¹⁴³ and thus one might think that heightened penalties may not be justified as applied to smaller entities.

As discussed above, contract fraud potentially may also be prosecuted under a variety of other statutes.¹⁴⁴ Statutory instruction on imprisonment and fines is limited under the various alternative stat-

140. The Federal Sentencing Guidelines were authorized in the Sentencing Reform Act of 1984. 28 U.S.C. § 994 (1994). Congressional debate on the Act in 1987 and 1988 occurred less than one year after the Sentencing Commission's initial guidelines took effect. See THOMAS W. HUTCHISON ET AL., *FEDERAL SENTENCING LAW AND PRACTICE* 1-2 (2000).

141. See *United States v. Nadi*, 996 F.2d 548, 551 (2d Cir. 1993) (limiting application so as to avoid "the potential anomaly of small subcontractors . . . being prosecuted under the Act").

142. See *Solem v. Helm*, 463 U.S. 277 (1983). This case was cited by the U.S. Chamber of Commerce in hearings before the Senate Judiciary Committee. See *Senate Hearings, supra* note 1, at 161. But see *Harmelin v. Michigan*, 501 U.S. 957, 965 (1991) (holding that Eighth Amendment does not require the magnitude of the punishment to be proportional to the offense).

143. See generally George J. Stigler, *The Optimum Enforcement of Laws*, 78 J. POL. ECON. 526 (1970) (discussing efficiency and the adequacy of deterrence under criminal statute enforcement regimes).

144. See *supra* note 55.

utes.¹⁴⁵ In general, like the Act, these statutes provide upper limits on the penalties to be levied.¹⁴⁶

Although the statutory language of the False Claims Act, False Statements Act, Mail Fraud Act, Wire Fraud Act and the Major Fraud Act differ in some respects, *all* of the acts require that penalties be determined in accordance with section 2F1.1 of the Federal Sentencing Guidelines related to fraud and deceit.¹⁴⁷ While the conspiracy statute does not explicitly reference section 2F1.1, section 2X1.1 links cases of conspiracy to the underlying substantive violation of fraud.¹⁴⁸ Unlike the threshold provision of the Act that ties application to the value of the contract,¹⁴⁹ punishment — both fines and imprisonment — under the Guidelines depends primarily on the amount of “loss.”¹⁵⁰ In other words, the punishment is intended to be proportional to the harm caused by the offense.¹⁵¹

Defining loss under the Guidelines is itself a disputed issue.¹⁵² The application notes (which are guidance materials prepared by the Sentencing Commission that accompany section 2F1.1), however, contain specific instructions with respect to contract fraud and indicate that loss includes consequential damages:

[L]oss in a procurement fraud or product substitution case includes not only direct damages, but also consequential damages that were reasonably foreseeable. For example, in a case involving a defense product substitution offense, the loss includes the government’s reasonably foreseeable costs of making substitute transactions Similarly . . . loss includes the reasonably foreseeable administrative cost to the govern-

145. For example, the False Claims Act, 18 U.S.C. § 287 (1994), and the False Statements Act, 18 U.S.C. § 1001 (1994), provide only that punishment include fines under “this title” and imprisonment of not more than five years.

146. The Act provides that, in general, fines should not exceed \$1,000,000 and that imprisonment should not exceed ten years. 18 U.S.C. § 1031(a) (1994).

147. See U.S. SENTENCING GUIDELINES MANUAL app. A (2000) (providing an index of applicable Guidelines Manual sections by statute).

148. See *United States v. Tatum*, 138 F.3d 1344, 1346-47 (11th Cir. 1998) (holding that procurement fraud guidelines under Section 2F1.1 should be applied in cases of conspiracy to defraud the government).

149. See 18 U.S.C. 1031(a).

150. USSG § 2F1.1(b)(1).

151. This aspect of proportionality was one of the goals of the Sentencing Reform Act of 1994, which sought to minimize differences in punishment for the same underlying conduct. See HUTCHISON, *supra* note 140, at 2.

152. See, e.g., *United States v. Hernandez*, 199 F.3d 1328 (4th Cir. 1999) (remanding a conviction under the Act and other statutes for recalculation of the amount of loss and re-sentencing); *United States v. Sublett*, 124 F.3d 693, 695 (5th Cir. 1997) (holding that the amount of loss should be decreased to account for legitimate services actually provided, even if the services were fraudulently provided); Tris Felix & Jason P. Hoffman, Note, *The Federal Judiciary in Discord: What is the Meaning of “Loss” Under the Federal Sentencing Guidelines Governing Fraud Offenses?*, 35 WASHBURN L.J. 179 (1995). This dispute will affect sentencing regardless of whether the Act or an alternative statute is used.

ment and other participants of repeating or correcting the procurement action affected¹⁵³

This provision ensures that the full extent of the harm, rather than an amount such as the contract value or profit, be considered when determining an appropriate punishment.

Moreover, following provisions introduced as part of the Act, the Guidelines provide that in cases involving “conscious or reckless risk of serious bodily injury” the offense level be increased by two levels to a minimum level of twelve.¹⁵⁴ This provision creates a minimum sentence of one year and increases sentences by approximately six months.¹⁵⁵ This additional penalty addresses what Congress believed to be especially egregious cases where substitution of defective products could endanger the lives of military personnel. Although this portion of the Sentencing Guidelines was added in conjunction with the Act, courts have held that it applies even when the Act is not the basis of the prosecution.¹⁵⁶

These effects of the Sentencing Guidelines were anticipated at the time of passage of the Act. The Department of Justice noted before the House Judiciary Committee:

[A]n initial reading of the guidelines would suggest that a first offender, the typical defendant in procurement cases, who organized a group . . . which conducted a . . . fraud costing the Government more than \$5 million, would receive a guideline sentence of 46 to 57 months. This guideline sentence, arising out of a very serious fraud, would be within the [five-year] statutory maximum permitted by existing law. . . .¹⁵⁷

The Department nonetheless supported the seven-year maximum because it believed that the Sentencing Commission might amend the Guidelines or that a judge might use the Act as a basis for departing upward from the prescribed sentence.¹⁵⁸ In the subsequent ten years, the Sentencing Commission responded only by providing clarification of the calculation of the loss.¹⁵⁹ Under the 1998 Guidelines, a sentence of seven years for a first-time offender would be possible only if the

153. USSG § 2F1.1, cmt. n. 8(c).

154. *Id.* § 2F1.1(7).

155. *See id.* § 5A.

156. *See, e.g.,* United States v. McCord, Inc., 143 F.3d 1095, 1097 (8th Cir. 1998) (holding that enhancement for “conscious or reckless risk” can apply in prosecutions under the False Statements Act); United States v. Hall, 71 F.3d 569, 571 (6th Cir. 1997) (recognizing that the enhancement can apply in cases where the fraud itself creates the risk but declining to apply the enhancement when the risk was created during flight from the police).

157. *House Hearings, supra* note 1, at 31.

158. *See id.* at 52-53.

159. *See* USSG § 2F1.1, cmt. n. 7.

loss exceeded \$40,000,000 and the fraud involved a conscious or reckless risk of serious bodily harm.¹⁶⁰

The effects of the Guidelines on fines similarly prevent punishments under the Act that might be considered unfair. Section 2F1.1 of the Sentencing Guidelines Manual does not contain special rules regarding fines, and thus fines are determined following the general Guidelines rule.¹⁶¹ With respect to organizational defendants, *base* fines may exceed \$20,000,000, and these base fines may be further multiplied under the Guidelines.¹⁶² Given the Act's limit of \$10,000,000, fines of organizational defendants under the Act may actually be limited compared to alternative statutes that simply provide for fines "under this title."

The situation is somewhat different for fines for individual defendants. While maximum fines for individuals are normally \$250,000,¹⁶³ that maximum does not apply if, as in this case, the statute authorizes a greater maximum fine.¹⁶⁴ Notwithstanding the standard limit, however, another section of the criminal code provides for an alternative maximum fine of twice the gain or loss associated with a fraud,¹⁶⁵ and this alternative maximum is available in prosecutions using alternatives to the Act. A fine exceeding the normal maximum of \$250,000 would be available under the Act and would be appropriate given the listed factors¹⁶⁶ only in circumstances in which a large loss was suffered. These same circumstances would also allow fines that exceed \$250,000 based on the section of the code allowing for fines based on the amount of loss or gain, even without the statutory maximum provided by the Act. The Act's heightened maximum fine provisions, therefore, have little effect when compared with the alternative law.

In sum, the punishment a wrongdoer receives will be equivalent whether prosecuted under the Act or an alternative statute. Therefore, objections to prosecution based on a concern over disproportionate punishment are not persuasive.

160. *See id.* §§ 2F1.1, 5A. Sentences for repeat offenders can more easily reach the seven-year maximum sentence.

161. *See id.* §§ 5E1.2(b), 8C2.4(b).

162. *See id.* § 8C2.4(d).

163. *See id.* § 5E1.2(c)(2).

164. *See id.* § 5E1.2(c)(4).

165. *See* 18 U.S.C. §§ 3571(b)(2), 3571(d) (1994). This alternative maximum is also referred to in the Act. *See* 18 U.S.C. § 1031(d) (1994).

166. *See* 18 U.S.C. § 1031(e). These factors mirror those used by the Sentencing Guidelines to establish the severity of punishment. *See* USSG § 5E1.2.

CONCLUSION

The Major Fraud Act is the appropriate statute under which to prosecute both contractors and subcontractors that have committed fraud against the United States. Language within the Act limiting liability to cases where “the value of the contract, subcontract, or any constituent part . . . is \$1,000,000 or more”¹⁶⁷ should not be interpreted to exclude from prosecution subcontractors on prime contracts with the government that exceed \$1,000,000, even if the value of the specific subcontract is less than \$1,000,000. Rather, the statute and its legislative history support prosecution of low-value subcontractors, as does the broader policy desire to utilize criminal statutes that are specifically tailored to the underlying offense.

Although less of a political issue than in the late 1980s,¹⁶⁸ fraud against the government continues to be a significant fiscal issue. The Department of Defense alone, for example, has a total annual budget approaching \$300 billion and spends approximately \$200 billion of that on defense contracts.¹⁶⁹ Recent defense spending increases are the largest since the mid-1980s, when the fraud scandals that led to the Act occurred,¹⁷⁰ and the George W. Bush administration has identified further increases as a priority.¹⁷¹ Despite the reforms of the past dozen years, the General Accounting Office considers defense contracting to be at high risk for fraud and other abuses,¹⁷² and fraud continues to

167. 18 U.S.C. § 1031 (1994).

168. A 2000 Gallup survey indicated that sixteen percent of people identified “education,” the most frequent response, as the country’s “most important problem,” with all economic issues accounting for less than thirty percent of responses. Government waste was not specifically identified among the responses. See Frank Newport, *Economy, Education, Health, Crime and Morality Most on American’s Minds*, GALLUP ORGANIZATION, June 22, 2000 available at <<http://www.gallup.com/poll/releases/pr000622b.asp>>. For “most important problem” survey results, see <<http://www.gallup.com/poll/indicators/Indmip.asp>>. In comparison, during testimony on the Act, witness Dina Rasor, of the non-profit group Project on Military Procurement, referred to a September 1988 *U.S. News and World Report* poll in which eighty-six percent of respondents answered that the next president should devote more resources to fighting waste and fraud and abuse within the government. See *House Hearings*, *supra* note 1, at 100.

169. See Greg Schneider, *Pentagon Seeks to Aid Defense Contractors*, WASH. POST, Feb. 8, 2000, at E1; *Dividing Defense Dollars*, WASH. POST, Sept. 24, 1998, at A23.

170. See Eric Pianin & Dan Morgan, *Congress Tapping Surplus for Tax Cuts, Domestic Programs*, WASH. POST, July 21, 2000, at A4; Eric Pianin, *Legislative Outlook is Mostly Dim*, WASH. POST, Jan. 4, 1999, at A4. These recent increases have been criticized by some on the grounds that the dollars could be found by trimming “pork” from the acquisition programs. See Editorial, *More Realistic Defense Budgeting*, N. Y. TIMES, Jan. 18, 1999, at A16.

171. See Thomas E. Ricks & Hanna Rosin, *Bush Pledges Safety of Social Security*, WASH. POST, June 7, 2000, at A6; Roberto Suro, *Joint Chiefs Aim Big Budget Request at Next President*, WASH. POST, June 5, 2000, at A1.

172. See Stephen Barr, *Identifying Risky Programs: GAO Lists 5 More as Vulnerable to Fraud, Waste, Abuse*, WASH. POST, Feb. 13, 1997, at A23; see generally U.S. GENERAL ACCOUNTING OFFICE, HIGH-RISK SERIES: DEFENSE CONTRACT MANAGEMENT (1997).

make the news.¹⁷³ Whether a particular bad actor happens to be the prime or subcontractor should not limit the ability of the United States to prosecute under the Act.

173. See Lorraine Adams, *Contractors in the Dock: 21 Charged After Undercover Probe of Navy Fraud*, WASH. POST, Aug. 20, 1999, at A33.