

Message from Our Managing Partner

Pepper's D.C. office has welcomed Government Contracts Practice Group partner **Michael R. Golden**. He focuses on federal procurement law, including bid protest litigation, contract formation and negotiated acquisitions. He is experienced in ethics, organizational conflicts of interest, small business programs and preferences, various elements of purchasing and contracting, major weapons system acquisition and contract administration.

And in this issue, Lance Jacobs and Marc Nickel explain the tax implications of the Council of the District of Columbia's plan to raise more revenue through revised corporate income reporting requirements. Tom Gallagher reports on the government's renewed war on defense-contractor fraud, particularly by contractors for the conflicts in Iraq and Afghanistan. We also spotlight a novel intellectual property case Pepper argued (and prevailed in) before the ITC, helping a client assert, then sell, its patent rights.

Online, Pepper's podcast center explores the new Federal New Issue Bond Program, midmarket pharma and health care deals, and we note the latest offerings among Pepper's Indian Series, Canadian Series, health care, life sciences, and sustainability webinars.

As always, we welcome comments, questions and suggestions.

David A. Wormser, Partner

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D.C. Plans to Raise Revenue Still Include Combined Reporting – This Time with Taxpayer Guidance

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This past August, the Council of the District of Columbia passed emergency legislation intending to address the District's projected budget gaps of hundreds of millions of dollars for the foreseeable future.¹ The key revenue raiser in that bill was a mandate that after December 31, 2010, all corporations taxable in the District would be required to use combined reporting to determine their income apportionable or allocable to the District.² It should be noted, however, that this emergency legislation expired after 90 days. As a result, the combined reporting provisions (as well as the other measures in the bill) sunset well before they had any impact on the District's businesses. However, in late December 2009, the council passed permanent legislation, deemed the Fiscal Year 2010 Budget Support Act of 2009. The act became effective on March 3, 2010 and restores the combined reporting provision, and several other provisions intended to raise revenue.

MISCELLANEOUS REVENUE RAISERS FROM EMERGENCY LEGISLATION RETAINED

Just as in the emergency legislation, the act decouples the District from the discharge of indebtedness income provisions of the American Recovery and Reinvestment Act of 2009, and increases the District's sales tax rate to 6 percent. Additionally, the act continues to authorize the District's chief financial officer to implement a tax amnesty for periods before December 31, 2009.

The act also retains the emergency legislation's replacement of the statute disallowing related party expense deductions. The history of this provision is replete with confusing placement in the statutes,

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followed by imprecise language, all of which served to make taxpayers question its applicability to corporate and other business entities, and whether it applied to deductions for anything other than royalties. The act clears up the confusion by repealing the current statute, the District's Code Section 47-1803.03(a)(19), and replacing it with a more clearly worded statute in Section 47-1803.03(d). The new statute specifically disallows deductions for interest and intangible expenses paid to related entities, as well as royalties. Importantly, the legislation makes this provision retroactively applicable to tax years beginning after December 31, 2008.³

All of these measures are intended to increase revenue; however, the act's most significant provision is its revised plan to implement combined reporting in 2011.

A DIFFERENT MANDATE FOR COMBINED REPORTING

The act retains the emergency legislation's combined reporting provisions, the most sweeping change contained in the legislation. Using identical language, the act requires that after December 31, 2010, "all corporations taxable in the District of Columbia shall determine the income apportionable or allocable to the District of Columbia by reference to the income and apportionment factors of all commonly controlled corporations organized within the United States with which they are engaged in a unitary business."⁴

Just like the emergency legislation, the act lacks any guidance or explanation as to what the District considers a unitary business, how the report is to be computed mechanically, or how tax attributes will be affected by the combined report. However, unlike the emergency legislation, the act itself does not make a legislative mandate that corporations use combined reporting in 2011, but rather it mandates that "[t]he Council shall pass legislation to require" such reporting. Accordingly, the council will have to write specific legislation or otherwise specify how the combined reporting regime is to be implemented for this provision to have any affect on corporations conducting business in the District.

PEPPER PERSPECTIVE

In order for this bill to become law, it must be signed by the mayor, pass a 30-day Congressional review, and be published in the *DC Register*. All of those requirements were met, and the act became District law on March 3, 2010. Just as with the emergency legislation, it is important to note that the provision on combined reporting is not effective until 2011. It should be noted that one of the biggest challenges – the lack of guidance

on *how* to report – has been partially addressed by putting the burden on the council to enact the combined reporting law, rather than simply requiring the District's corporate taxpayers to file blindly starting in 2011. Given the amount of negative feedback the Council received from business taxpayers on the emergency legislation, the establishment of combined reporting in the District is far from inevitable. The fact remains, though, that the District's fiscal affairs are still out of order, and will likely remain so for the foreseeable future. Accordingly, taxpayers should expect that the council will seek to enact a combined reporting scheme, regardless of how unpopular it may be.

ENDNOTES

- 1 District Bill # 18-0409, Act # 18-0187 (enacted Aug. 26, 2009), *available at* <http://www.dccouncil.washington.dc.us/images/00001/20090819131730.pdf>.
- 2 *See* "D.C. Enacts Combined Reporting, Sort Of: Other Provisions Included as Attempts to Raise Revenue" (Oct. 8, 2009), *available at* http://www.pepperlaw.com/publications_update.aspx?ArticleKey=1612.
- 3 District Bill # 18-0203, Act # 18-0255, Title VII, Subtitle F, Sec. 7082.
- 4 District Bill # 18-0203, Act # 18-0255, Title VII, Subtitle U.

War on Fraud in the Defense Industry

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In March 2009 President Obama took aim at wasteful government spending, and defense contractor fraud was at the center of the bull's eye. The President declared war on the "outright fraud" present in government contracts, causing losses in the billions of dollars. The President decried the "broken" contracting system and announced procurement reform and renewed enforcement efforts. The President stated:

We are spending money on things that we don't need, and we are paying more than we need to pay. And that's completely unacceptable. ... In Iraq, too much money has been paid out for services that were never performed, buildings that were never completed, companies that skimmed off the top.

One year later, the President's war on fraud in the defense industry has gained momentum and will not slow down any time soon.

The increased oversight of defense contracting fraud can be seen on multiple fronts, including increased budgets for the Department of Defense investigative agencies, significant congressional oversight, and aggressive investigations by the Department of Justice (DOJ) and several United States Attorney's Offices.

Perhaps no case better demonstrates the Justice Department's focus on defense contracting fraud than the indictment unsealed in the Northern District of Georgia in November 2009. In *United States of America v. The Public Warehousing Company, K.S.C., a/k/a Agility*, DOJ charged a Kuwaiti company with multiple conspiracies to commit major fraud and make false statements to the United States in connection with multi-billion-dollar prime vendor contracts to provide food and other products to the military and others in the Middle East, including in Iraq, Kuwait and Jordan. The indictment alleged that Public Warehousing Corporation (PWC) overcharged the government in the execution of an \$8.5 billion contract to supply food in the Iraq war zone.

The first alleged conspiracy involves fraud in the solicitation and award of a prime vendor contract. The Defense Supply Center Philadelphia (DSCP), the troop support center component of the Defense Logistics Agency, which manages the contracting process for feeding the troops throughout the world, issued

IT IS NO SURPRISE THAT THE ENFORCEMENT FOCUS IS ON COMPANIES INVOLVED IN PROVIDING EQUIPMENT AND SUPPLIES TO THE MILITARY, PARTICULARLY THOSE WITH A CONNECTION TO THE IRAQ WAR ZONE OR AFGHANISTAN. CONTRACTORS CAN EXPECT INCREASED SCRUTINY OF THEIR ACTIVITIES BY THE DEPARTMENT OF JUSTICE.

solicitations for proposals to provide food to troops in Iraq. The indictment alleges that PWC defrauded DSCP by making material false statements, using false documents and concealing material facts in the prime vendor contract solicitation and award process.

The indictment also alleges a widely ranging conspiracy between PWC and its subcontractors to overbill the government through various means including:

- failing to purchase less expensive products unless vendors provided prompt payment discounts to PWC
- disguising costs as part of the "delivered price" for products in order to overcharge the government
- manipulating and inflating the "delivered price" to the government by negotiating rebates or discounts, and then keeping and not disclosing those discounts to the government
- encouraging subcontractors to provide disguised discounts to PWC under false labels to benefit PWC and prevent DSCP from discovering the discount.

The indictment alleges that these and other schemes to defraud prevented the government from determining the true price of

the contracted goods and resulted in fraudulent overbilling.

While the United States Attorney's Office for the Northern District of Georgia, along with multiple law enforcement agencies, have been investigating PWC for several years, other U.S. attorneys have successfully investigated and prosecuted companies related to PWC. The United States Attorney's Office in the Southern District of Texas investigated principals of American Grocers, Inc. (AGI) for misrepresenting the cost to deliver food to U.S. troops in Iraq and Kuwait under a contract with PWC. Three individuals pleaded guilty in April and July 2009 and appear to be cooperating with law enforcement authorities.

In July 2009, Samir Mahmoud Itani pleaded guilty to conspiring to defraud the United States. Itani owned, controlled and operated AGI, a Houston food export company, which furnished food as a subcontractor to PWC under the prime vendor contracts to supply food to U.S. troops. Itani pled guilty to conspiring with PWC and others to include and conceal overcharges on AGI's invoices to PWC. Those invoices were ultimately presented to the United States by PWC. Itani pleaded guilty to concealing bogus trucking costs on AGI's invoices, as well as using fabricated invoices purportedly from Logistics Group International, Inc. (LGI) for food shipments that never occurred.

In addition to the successful prosecution of Samir Itani, the U.S. attorney also prosecuted Frederick Kenvin, an AGI employee, and Steven Day, the president and owner of LGI, as co-conspirators in the fraudulent activity. While Day was sentenced to

probation after cooperating with the government, Kenvin and Itani appear to be cooperating, while pending sentencing.

Last month, Senate Armed Services Committee Chairman Carl Levin wrote to Attorney General Eric Holder requesting a criminal investigation of Raytheon Company and Xe Services LLC (formerly Blackwater) for "false or misleading statements in their submission of a contract proposal to the U.S. Army." After hearing testimony at a Senate Armed Services Committee hearing, Chairman Levin asked that the Department of Justice investigate the \$25 million Defense Department subcontract.

In this first year since the President's call to arms to investigate and prosecute fraud in the defense contracting industry, the Department of Justice has investigated significant prime vendor contractors and their relationships with multiple subcontractors. It is no surprise that the enforcement focus is on companies involved in providing equipment and supplies to the military, particularly those with a connection to the war zone in Iraq or Afghanistan. Contractors can expect increased scrutiny of their activities by the Department of Justice. The acting United States attorney for the Northern District of Georgia made it clear in his public statement regarding the indictment of PWC: "Others who have engaged in similar conduct should beware. This indictment is only the first step. Our investigation of entities and persons who have defrauded the United States and our military is ongoing."



Peppercast: Housing Update Live – Federal New Issue Bond Program

Pepper Hamilton partner Shel Schreiber recently hosted another Housing Update Live! conference in our Washington, D.C. office. Our special guest was Harry Sewell, executive director of the District of Columbia Housing Finance Agency. The principal discussion of the session was about the Federal New Issue Bond Program, but the session covered a range of topics, including the District's administration of the American Recovery and Reinvestment Act funds and its experience with exchange funds.

Listen today by visiting the Affordable Housing and Community section of Pepper's podcenter at www.pepperpodcasts.com.

Patent Owners Find Protection in Landmark Case Argued Before ITC by Pepper Hamilton

Legal Victory Accelerated the Sale of Saxon Innovations LLC

Pepper Hamilton LLP has prevailed in a cast that led to a recent ruling by the International Trade Commission (ITC) that will have major implications for companies that license their patent portfolios to U.S. businesses.

“This is an important ruling that significantly impacts technology companies who license their patent portfolios, as well as venture capital and private equity firms with portfolio companies that hold valuable patents,” said William D. Belanger, a partner in Pepper’s Boston office. “The ruling gives patent owners greater flexibility to enforce their intellectual property and may result in more case filings at the ITC.”

The ITC has become an important venue for patent disputes because of its power to issue orders barring the importation of goods that infringe on U.S. patents. A 2006 Supreme Court ruling made it much more difficult to obtain broad injunctions against infringing goods in federal court, so increasingly patent holders are turning to the ITC for relief. However, very few practitioners are experienced in the rules and requirements of litigation before the ITC. Pepper is one of those few firms.

To win a patent dispute before the ITC, the plaintiff must establish a domestic industry related to the patent at issue. The ruling in *Certain Electronic Devices Including Handheld Communications Devices*, (Inv. 337-TA-673 and 337-TA-674), which caused ripples in the intellectual property field, held that patent owners can fulfill the domestic industry requirement based exclusively on the activities of their domestic licensees.

Pepper attorneys, representing Saxon Innovations LLC, filed a complaint for patent infringement against prominent international technology companies, including Samsung, Nokia, HTC, Palm and Sharp.

“One key issue in this case centered on establishing a domestic industry related to the patent. Typically, parties satisfy the domestic industry requirement by pointing to an existing factory or R&D facility that employs the patented technology,” said Aaron

Upcoming Webinars

INDIAN WEBINAR SERIES: HIDDEN EMPLOYMENT LAW RISKS IN DOING BUSINESS IN THE UNITED STATES

Wednesday, March 24, 2010

11:00 A.M. - 12:00 P.M. Eastern

DUMPING PHARMA

Health Care Legal Issues for 2010 and Beyond Webinar Series

Thursday, March 25, 2010

12:00 - 1:00 P.M. Eastern

CRITICAL CONSIDERATIONS IN DISTRESSED M&A TRANSACTIONS: EXPLORING RISKS AND OPPORTUNITIES

Wednesday, April 7, 2010

12:00 - 1:00 P.M. Eastern

HEALTH CARE PRIVACY AND SECURITY AFTER HITECH

Health Care Legal Issues for 2010 and Beyond Webinar Series

Thursday, April 22, 2010

12:00 - 1:00 P.M. Eastern

CANADA-U.S. TRADE UPDATE LUNCHEON

Canadian Webinar Series

Thursday, April 29, 2010

12:00 - 1:00 P.M. Eastern

SOLAR POWER FOR END USERS - WHERE TO STORE?

Thursday, May 6, 2010

12:00 - 1:00 P.M. Eastern

LEASE CONSIDERATIONS FOR GREEN BUILDING

Wednesday, May 19, 2010

12:00 - 1:00 P.M. Eastern

GREEN BUILDING FOR OWNERS

Wednesday, June 9, 2010

12:00 - 1:00 P.M. Eastern

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Levangie, an associate in Pepper's Boston office. "In Saxon's case, we focused on domestic companies who licensed the asserted patents, and those licensee's activities exploiting the patented technology in the United States." The ITC ultimately ruled in favor of Saxon, creating an opportunity for patent owners who have licensed their portfolios to domestic companies.

"Pepper Hamilton helped manage this opportunity for us from the initial acquisition through the sale of the asset. This was a complex IP monetization program, and required a truly sophisticated partner, which they proved to be," said Bill Marino, CEO of Saxon Innovations. "Pepper's ITC expertise, combined with their industry knowledge and ability to manage this program on an alternate fee basis, was critical to our company's success."

"Our success at the ITC ratified the value of Saxon's patent assets and Pepper's work in obtaining this ruling and at trial was key in driving the sale," said Marino. "For such a major transaction, this deal was finalized in a remarkably short timeframe. The value of the patent sale was increased by Pepper's seamless representation on litigation and transaction matters, as well as the ITC's willingness to protect Saxon's domestic licenses."

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The Deal and Pepper Hamilton's Legal Roadmap to Success - Midmarket Pharma, Health Care Deals

There are a number of hot-button legal topics interesting to dealmakers at the moment. What key legal issues should you be thinking about in the coming months? Hear thoughtful perspectives in this series of incisive podcasts from The Deal and Pepper Hamilton LLP.

The Deal

EPISODE 1: PEPPER HAMILTON ON MIDMARKET PHARMA, HEALTH CARE DEALS

Pharma and health care deals seem to have remained recession-proof. As the economic environment improves, Pepper Hamilton partners Christopher S. Miller and John W. Jones, Jr. believe dealmaking in the sector is likely to pick up. In this podcast sponsored by Pepper Hamilton, the two discuss the larger issues facing the industry and how they will affect dealmaking.

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