You may have noticed that, from time to time, we write articles about fraud and fraud-related litigation in the government contracting arena. We've discussed legal settlements, and noted inconsistencies in how the Department of Justice comes to an acceptable plea bargain with an alleged fraudster. We've discussed *qui tam* litigation under The False Claims Act, and how your disgruntled employee (and disgruntled former employee) may have the means to make your life miserable through filing a suit—even when that selfsame relator was in fact the perpetrator of the activity that is now alleged to be fraudulent. We've discussed how violations of export controls can lead to allegations of false claims; we've discussed how violations of the Truth-in-Negotiations Act (TINA) can lead to allegations of false claims; and we've discussed how misrepresentation of one's business size and/or socioeconomic status can lead to allegations of false claims.

You might say we've been into this government fraud thing like it was our professional livelihood. Which, to some extent, it is. Given that it's just a fine line dividing intentional fraud from an honest misunderstanding of the applicable (and complex) regulations, we have developed—by necessity—a rather keen sense of which is which. (See the **recent article** on The Dunning-Kruger Effect, which explains the psychology of how cognitive bias and other errors creep into management decision-making.)

Throughout the myriad fraud-related articles published on this site, we've been consistent that organizations that choose to do business with the Federal government *must* invest in sufficient controls to prevent (or at least reduce) wrongdoing. It's simply risk mitigation, if nothing else. If you tell Apogee Consulting, Inc. that you lack sufficient budget to invest in your internal controls, we are very apt to ask if you have sufficient budget to pay multi-million dollar fines and penalties, or to pay for attorneys to defend you from fraud allegations. If you tell us that you don't have the money to do the job the right way, then we are very apt to advise you not to do the job at all.

(Why, yes. This tendency does lead to a bit of client churn. Why do you ask?)

In February, 2010, we **asked the question** whether the price of fraud was expensive enough to deter wrongdoers. Since then, we've written about a **$500 million** settlement at SAIC, the loss of a **$20 billion** follow-on TRICARE contract at TriWest, and other big-time consequences. Yet nothing seems to change. It appears that malefactors simply don't factor-in the big-time consequences when they are deciding whether or not to engage in fraud.

We raised that very same issue once again in July, 2012, when **we discussed** United Technologies Corporation (UTC) and its $76 million settlement with the Department of Justice, related to violations of the Arms Export Control Act by a Canadian subsidiary of UTC. We asked—

We wonder if the UTC subsidiary (Pratt & Whitney Canada) took a $76 million fine into account, when it calculated the risks associated with its intentional export control violation? We think not.

So we've discussed fines and penalties, and settlements, and legal defense fees. And those certainly seemed to us that they should deter somebody with half a brain. But we haven't really discussed another consequence of fraudulent activity—the **shareholder derivative suit** . This situation occurs when a shareholder sues in the name of the corporation to remedy a perceived wrongdoing, when for some reason the corporation is unwilling to do so. As the Free Dictionary writes—

The principal justification for permitting derivative suits is that they provide a means for shareholders to enforce claims of the corporation against managing officers and directors of the corporation. Officers and directors, who are in control of the corporation, are unlikely to authorize the corporation to bring suit against themselves. A derivative suit permits a shareholder to prosecute these claims in the name of the corporation.

Consequently, if one or more corporate shareholders believe that the corporate management and/or the Board of Directors have failed in their duties to prevent fraud, then they are likely to file a derivative suit in the name of the corporation against those officers and/or directors. Which can also be very expensive, from a legal expense point of view (if for no other reason).

UTC was reminded of this additional consequence recently, when a shareholder sued on behalf of the corporation, seeking to replace the company's entire Board of Directors—according to **Bloomberg** . The Bloomberg article reported—

Directors of the Hartford, Connecticut-based industrial conglomerate should have exercised better oversight to avoid U.S. fines for supplying China with software used in developing attack helicopters, the Harold Grill 2 IRA contends in a lawsuit filed Nov. 5 in Delaware Chancery Court in Wilmington.

Board members violated their duties 'by abdicating their responsibilities of supervision and oversight' and as a result 'sullied United Technologies' reputation as a defense contractor, undermined its claims to good governance, and exposed it to criminal charges,' the investor claimed. …

In the lawsuit, lawyers contend the company 'secretly participated' in the Chinese military helicopter development 'in violation of a U.S. arms embargo and federal arms traffic control statutes,' placing restricted technology in the hands of 'the U.S.'s biggest geopolitical competitor.' …

The investor asked a judge to remove and replace the directors, order a new election, appoint a receiver for management in the interim, and award the company damages to be paid by the directors.

When the UTC AECA violations first came to light last June, we asked whether a $76 million fine was considered when setting out to make revenue targets. Apparently not, was our answer. And now we update that question to inquire whether the cost of defending (and perhaps settling) a shareholder derivative suit was factored-in to the risk/reward calculations. We continue to suspect not.

Fraud is expensive. Derivative suits are expensive. Consider those facts, if you will, the next time you set forth to establish your budgets for employee training, internal audits, and other internal control procedures.