

Washington TECHNOLOGY

Federal Lawsuit Adds to AMS Woes

07/30/01

By *Patience Wait*,
Staff Writer

Company Also Faces Trouble in Ohio, Vermont

The \$350 million lawsuit filed July 17 against American Management Systems Inc. by a federal agency for alleged failure to perform is the latest in a string of legal conflicts, which are casting a pall on the company's operations.

Not only is AMS facing legal trouble with the Federal Retirement Thrift Investment Board, but the Fairfax, Va., integrator is also experiencing problems with two state information technology systems — in Ohio and Vermont — that have prompted investigations and a lawsuit. These problems come less than a year after the company settled a large lawsuit with Mississippi.

Elizabeth Ready, the auditor of accounts for Vermont, said July 20 that significant problems cropping up in the state tax department's new automated system are causing her to consider investigating the \$14 million system created by AMS.

Ready said she was aware of AMS' \$185 million settlement last year with Mississippi, following the failed implementation of a tax system there, and she has been keeping abreast of developments in Ohio, where AMS has been named as a defendant in a class action lawsuit over the processing of child support payments.

"Whenever you see the magnitude of problems we've had here in Vermont, you want to look at everything," Ready said. "It would not be right to blame the company for any of these problems at this point, but surely it would be appropriate to take a look."

AMS officials did not respond to requests from Washington Technology seeking comments regarding the allegations against the company.

The Vermont tax system has been slow to process income tax returns, Ready said. It also has generated some 23,000 erroneous letters to taxpayers. Most of the letters had no material impact on the recipients, she said, but the cost of the incorrect mail and the confusion created are significant.

"I'm not impugning the company at all, [but] I begin to wonder if there are similarities between the problems here," Ready said. She was referring to the problems that dogged AMS on a project to create a customized record-keeping system based on a commercial product for the Federal Retirement Thrift Investment Board.

The board, which administers a savings program for federal workers, awarded the \$30 million contract to AMS in May 1997. It terminated the contract and filed suit in U.S. District Court July 17, alleging that AMS failed to meet numerous delivery schedules and misled the board about its ability to deliver the finalized system.

The lawsuit asks for \$50 million in actual damages and \$300 million in punitive damages.

In a prepared statement released July 17, AMS officials strongly denied the charges and said they

will fight the lawsuit. They also contend they tried unsuccessfully to meet with the board and resolve problems with the system.

“We expected to have a meeting, [but] we got the termination and lawsuit. I’m really angry at this turn of events,” said Acting Chief Executive William Purdy during the company’s scheduled quarterly conference call with analysts July 20. “I fully believe we could have turned [the situation] around with the cooperation of the board.”

The system’s ballooning costs, which have risen to an estimated \$90 million, are the result of the numerous changes and additional writing of computer code requested by the retirement board, AMS officials said. Purdy said the lawsuit is an attempt by the agency to shift responsibility for delays and significant cost overruns from itself to AMS.

Despite the company’s defense of its actions, many people said they are troubled by AMS’ recurring problems.

“This seems like what happened in Mississippi. ... It seems like they were given a fair chance on this thing,” said Tom Meagher, vice president of equity research with BB&T Capital Markets, Richmond, Va. “It’s uncanny the way this company can explode once a year. There’s three quarters of building the stock, [then] one quarter will send it into the toilet.”

Against the backdrop of the federal lawsuit, AMS is caught up in a class action lawsuit filed in Ohio in late May by the Toledo chapter of the Association for Children for Enforcement of Support, a national advocacy group. That lawsuit alleges that a statewide child support collection and payment system set up and operated by the Department of Job and Family Services, AMS and Bank One does not comply with federal and state standards.

The water is further muddied by an investigation conducted by Ohio’s Office of Inspector General that found the former director of the agency improperly obtained consulting deals with AMS and another major systems integrator soon after leaving government employ.

The inspector general’s office found that AMS received more than \$100 million in unbid contracts from the Ohio agency in 1998 and 1999.

The inspector general’s report concluded there appears to be “no obvious improprieties” in the way AMS obtained and managed its contracts. However, the former agency director may have violated the state’s revolving door policy, which requires government officials to wait one year before representing clients on matters they were involved in while on the state payroll.

“The connection that ended up being troublesome was that they were the first out of the chute in paying [the former state employee],” said Arnie Schropp, deputy inspector general. “We have referred our investigation to the county prosecutor, the auditor of the state and the state attorney general’s office.”

The Franklin County, Ohio, prosecutor will determine whether to file any criminal charges against the former agency director, while the state attorney general has jurisdiction over civil matters involving the two companies.

AMS is not the only IT company that has dealt with lawsuits or disgruntled government customers.

Electronic Data Systems Corp., Plano, Texas, recently absorbed \$40 million in unforeseen development costs on a Texas Medicaid system as a result of a dispute. In addition, EDS and Florida fought it out in court in the early 1990s over a \$240 million automated welfare system that

**American Management Systems
Inc.**
www.amsinc.com

President & CEO: (Interim)
William Purdy
2000 Sales: \$1.279 Billion
2000 Net Income: \$43.8 Million
Ticker: AMSY on Nasdaq

broke down repeatedly. EDS finally prevailed when a circuit court judge followed an arbiter's ruling and ordered the state to pay the company for work it had done.

Lockheed Martin Corp. of Bethesda, Md., got into a dispute with California about the increasing cost of creating an automated child welfare system. The judge presiding over the non-jury trial eventually ruled in Lockheed Martin's favor and ordered the state to pay the company, but the amount was significantly less than the company sought.

"The successful development of a significant information system involves in equal measure a commitment by the client organization and the vendor," said Bob St. Jean, a research analyst with J.P. Morgan in New York who tracks AMS.

Similarly, Jonathan Cain, an attorney with Mintz Levin Cohn Ferris Glovsky and Popeo PC, a law firm in Reston, Va., said: "In virtually every case I've ever litigated, there's a combination of causes that lead to the perceived failure of the project." A customer, for example, may keep changing its mind about what the project should include, while a vendor goes through personnel changes over the course of the project, he said.

St. Jean, who used to work as a software development project manager for a large federal IT company, said he did not regard the problems facing AMS as unique.

But others are uncertain. Ray Bjorklund, vice president of consulting services for Federal Sources Inc. in McLean, Va., said AMS' woes are not typical.

"Companies do get involved in a string of litigation, but you don't see them in the news so close together," he said. "AMS is probably going through a little string of bad luck here."

Many Wall Street investors reacted negatively to the retirement board's lawsuit, driving AMS' share price down nearly 24 percent to \$16.24 the day the lawsuit was filed. The share price has since rebounded slightly, closing at \$17.02 July 24.

Vermont's Ready said an initial review of the tax system implemented by AMS has turned up some problems, some of which seem caused by inadequate management controls, others which appear based in the system itself.

"There are a number of functionality issues with the new system, and they raise concerns," Ready said. "First, according to the suits filed against AMS, they failed to produce fully functional systems" in accordance with the terms of their contracts.

The second red flag is AMS' recent financial woes, Ready said. Between settling litigation and sagging stock prices, Ready expressed concern that the state could be at risk in terms of supporting the newly installed system if the company's long-term viability is threatened.

"It's just a flashing red light that says, 'Look at this,' " she said.

© 1996-2005 Post-Newsweek Media, Inc. All Rights Reserved.