

# Ethics and the Government Contractor: Traversing the New Compliance Rules

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# Agenda

- The New FAR Rules
  - Covered Contracts
  - Hotline Posters
  - Compliance Program
  - Mandatory Disclosure
  - Full Cooperation
  - Suspension/Debarment
- Effective Compliance Programs & Risk Assessments
- Internal Investigations & The Decision to Disclose
- Questions

# The New FAR Rules

# An Overview of the Recent Requirements

Type Of Requirements	Clauses/Coverage	Scope of Requirements
"Should have" requirements (non-mandatory)	FAR 3.1002 -applies to all federal contractors	-code of conduct -compliance program -internal control systems (suitable to size, facilitate discovery and disclosure)
Contract based mandatory compliance and disclosure requirements	FAR 52.203-13 -in solicitations and contracts expected to exceed \$5M and 120 days and issued after the effective date (12/12/08), prior version possible in earlier 08 solicitations and contracts  FAR 52.203-14 -to be included in contracts other than for commercial items or to be performed entirely outside US	-code of conduct to contract employees - <u>mandatory disclosure</u> -compliance program (unless small or commercial item) to include training -internal control system ( <u>not applicable</u> ) to commercial item <u>contracts</u> ) -flow down to subcontracts which exceed \$5M and 120 days -display of agency hotline poster as identified
Contractor qualification requirements (responsibility, suspension, debarment, past performance, etc.)	FAR 9.104-1, 9.406-2, 9.407-2, 42.1501 -applies to all federal contractors	-new cause of debarment for knowing failure by principal to timely disclose (based on credible evidence) certain criminal violations, false claims, or significant overpayments related to a contract -consideration of record of ethics as part of responsibility and past performance evaluations -consideration of contractor compliance efforts as mitigation

# Applicability: FAR Covered Contracts

- Requirements Will Apply:
  - Traditional FAR Contracts
  - FSS Contracts
  - Blanket Purchase Agreements
- Requirements Will Not Apply:
  - Grant Agreements
  - Cooperative Research and Development Agreements
  - Other Transactions Agreements
  - Contracts not using appropriated funds
    - E.g., FDIC, USPS, AAFES
- Disclosure Requirement Effective When FAR 52.203-13 Incorporated into Contracts (subject to dollar amount and duration provisions)
- Suspension/Debarment Provisions Effective on December 12, 2008

## Display of Hotline Posters: FAR 52.203-14

- Effective December 24, 2007, contractors are required to display government fraud hotline posters unless the contractor has implemented a business ethics and conduct awareness program, including a reporting mechanism, such as a hotline poster.
- If the contractor does not have a business ethics and conduct awareness program, the hotline poster must be displayed:
  - During contract performance in the United States, with display in common work areas within business segments performing work under the contract and at contract work sites
  - On the contractor's website, if the contractor maintains a company website as a method of providing information to employees
- Does not apply if the contract is for a commercial item or is to be performed entirely outside the United States.
- Contractor must flow-down the requirement in all subcontracts that exceed \$5,000,000, except those for commercial items or that will be performed entirely outside the U.S.

## New provisions in FAR 52.203-13

- Business ethics awareness and compliance program (FAR 52.203-13(c)(1))
- Internal control system (FAR 52.203-13(c)(2))

### **Covered contracts**

- These requirements do NOT apply to contracts for commercial items or those in which the contractor has represented itself to be a small business concern.

## Mandatory Disclosure Obligation: FAR 52.203-13

- **Final Rule:** Contractors must timely disclose, in writing, to the agency OIG, with a copy to the CO, “whenever, in connection with the award, performance, or closeout of this [prime] contract or any subcontract thereunder, the Contractor has credible evidence” that a principal, employee, agent, or subcontractor of the Contractor has committed: (a) a violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations; or (b) a violation of the civil False Claims Act.
- **Preamble:** The Councils replaced the “reasonable grounds to believe” standard contained in the second Proposed Rule with a “credible evidence” standard. According to the Councils, “[t]his term indicates a higher standard, implying that the contractor will have the opportunity to take some time for preliminary examination of the evidence to determine its credibility before deciding to disclose to the Government.” 73 Fed. Reg. 67073.
  - Contractor cannot investigate to conclusion; must disclose when credible evidence is found.
  - The Councils clarified that the new standard does not impose an obligation to undertake a complex investigation, but “only to take reasonable steps that the contractor considers sufficient to determine that the evidence is credible.”



## Mandatory Disclosure Obligation (cont'd): The False Claims Act

- Under 31 U.S.C. § 3729(a), a person can be liable for violating any of seven different provisions
- The four main ones are, a person is liable who:
  - “*knowingly presents to an officer or employee of the United States Government or causes to be ...a false or fraudulent claim for payment or approval*”
  - “*knowingly makes, uses, or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government*”
  - “*conspires to defraud the Government by getting a false or fraudulent claim allowed or paid*”
  - “*knowingly makes or uses, or causes to be made or used, a statement to conceal, avoid, or decrease an obligation to pay or transmit money or property to the Government*”

## Mandatory Disclosure Obligation (cont'd): The False Claims Act

- The term “knowingly” is defined to include:
  - Actual knowledge
  - Deliberate ignorance
  - Or reckless disregard of the truth or falsity of information subject to the Act
- Thus, the Government does not have to prove that the person or firm actually deliberately attempted to defraud the Government
- The “reckless disregard” standard is a much easier to meet standard than criminal standards for conviction
- Actions of individuals or employees are imputed to the company

## Mandatory Disclosure Obligation (cont'd): Violation of Civil FCA

- Comments to the proposed rules revealed a concern about the difficulty of determining whether a violation of the FCA has occurred, and, further, a concern about the broad scope of FCA.
- **Final Rule:** Violations of the civil FCA remain a required disclosure under the mandatory disclosure requirement and the suspension and debarment provisions, but the trigger has increased from “reasonable probability of a violation” to “credible evidence of a violation.” See FAR 9.406-2(b)(1)(B), 9.407-2(a)(8)(ii), 52.203-13(b)(3)(i)(B).
- **Preamble:** The Councils acknowledged that some issues concerning the proper application of the civil FCA remain unsettled, but reasoned that “[g]enuine disputes over the proper application of the civil FCA may be considered in evaluating whether the contractor knowingly failed to disclose a violation of the civil FCA.” 73 Fed. Reg. 67082.

## Mandatory Disclosure (cont'd): Applicable Contracts

- **Final Rule:** The mandatory disclosure requirements apply to federal contracts with a performance period of 120 days or more and a value of more than \$5 million, including Federal Supply Schedule (FSS) Contracts with an anticipated overall value of more than that amount.
  - This applies to all government contracts, including those for commercial items and those performed exclusively overseas.
- **Preamble:** The Proposed Rule did not address whether the \$5 million threshold applied to FSS contracts on an order-by-order basis or to the contract value taken as a whole. The Councils clarified that “unless otherwise specified, if the action establishes a maximum quantity of supplies or services to be acquired, the final anticipated dollar value must be the highest final priced alternative to the Government, including the dollar value of all options.” 73 Fed. Reg. 67085.

## Mandatory Disclosure (cont'd): Subcontractors

- **Final Rule:** The Rule mandates flow-down of the disclosure requirements contained in FAR 52.203-13 for subcontracts with a value in excess of \$5 million and a performance period of more than 120 days. FAR 52.203-13(d).
- **Preamble:** The Councils clarified that a prime contractor is subject to debarment if it fails to disclose known violations by the subcontractor. Furthermore, subcontractors report violations directly to the OIG rather than through the prime contractor.

## Full Cooperation

- **Final Rule:** A contractor's internal control system must provide for "full cooperation with any Government agencies responsible for audit, investigation, or corrective action." FAR 52.203-13(c)(2)(ii)(G).
  - "Full cooperation" means/includes:
    - Disclosure to the Government of the information sufficient for law enforcement to identify
      - (1) the nature and extent of the offense, and
      - (2) the individuals responsible for the conduct.
    - Providing timely and complete response to Government auditors' and investigators' request for documents and access to employees with information. FAR 52.203-13(a)(1).
- **Preamble:** The Councils stated that the definition of full cooperation incorporates the US Sentencing Guidelines' general principle that cooperation be both "timely and thorough." "It is intended to make clear that cooperation should include all information requested as well as all pertinent information known by the contractor necessary to complete the investigation." 73 Fed. Reg. 67078.

## Full Cooperation (cont'd)

- The Proposed Rule was silent regarding the inter-relationship of the disclosure requirement to applicable privileges.
- **Final Rule:** “Full cooperation . . . does not require—
  - (i) A Contractor to waive its attorney-client privilege or the protections afforded by the attorney work product doctrine; or
  - (ii) Any officer, director, owner, or employee of the Contractor, including a sole proprietor, to waive his or her attorney client privilege or Fifth Amendment rights . . . .” FAR 52.203-13(a)(2).
- **Preamble:** The Councils confirmed that they had added a new definition of “full cooperation” to make clear that the rule does not mandate disclosure of materials covered by the attorney work product doctrine. The Councils also confirmed that, for comparison purposes, it is instructive to refer to the flexible approach in the US Sentencing Guidelines. 73 Fed. Reg. 67077.

## Suspension and Debarment: FAR 9.406-2 & 9.407-2

- **Final Rule:** The Rule added as a cause for suspension and debarment:

“Knowing failure by a principal, until 3 years after final payment on any Government contract awarded to the contractor, to timely disclose to the Government, in connection with the award, performance, or closeout of the contract or a subcontract thereunder, credible evidence of—

  - (A) Violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code;
  - (B) Violation of the civil False Claims Act; or
  - (C) Significant overpayment(s) on the contract. . . .”



## Suspension and Debarment (cont'd): Applicable Contracts

- New causes for suspension and debarment apply to all Government contracts, regardless of whether they include the newly revised version of FAR 52.203-13.
  - Unlike contracts subject to mandatory disclosure, no dollar value threshold applies.
  - Applies to overseas contracts, small business contracts, and commercial item contracts.
  - Applies to contracts that pre-date the Final Rule where contractors have credible evidence of a past violation related to a contract that was not closed out before December 12, 2005, even though the contractor is not subject to the new mandatory disclosure provisions, which are prospective only.

## Suspension and Debarment (cont'd): Grounds for Suspension/Debarment

- **Final Rule:** The suspension and debarment provisions are triggered by the principal's failure to disclose "credible evidence of" a violation. FAR 9.406-2(b)(1)(vi), 9.407-2(a)(8).
- **Preamble:** Although the final rule now incorporates the "credible evidence" standard into the suspension and debarment provisions, the Councils stated in the Preamble that "the question of timely disclosure will not come up unless the Government independently discovers that there has been a significant overpayment, a violation of the civil FCA, or a violation of Federal criminal law to be disclosed, that the Contractor knew about and elected to ignore. It is unlikely that any contractor would be suspended or debarred absent the determination that a violation had actually occurred." 73 Fed. Reg. 67078.

## Suspension and Debarment (cont'd): Knowledge Requirement

- **Proposed Rule:** The Proposed Rule did not specify who within an organization must have “knowledge” sufficient to trigger the reporting requirements.
- **Final Rule:** The Councils revised the suspension and debarment provisions to require disclosure when a “principal” of the company has knowledge of a violation. “*Principal* means an officer, director, owner, partner, or a person having primary management or supervisory responsibilities within a business entity (e.g., general manager; plant manager; head of a subsidiary, division, or business segment; and similar positions).” FAR 2.101(b)(2).
- **Preamble:** The Councils agreed that knowledge cannot be imputed and that the principal must have knowledge of the violation. However, they cautioned that “principal” should be interpreted broadly, and includes compliance officers or directors of internal audit, as well as other positions of responsibility. 73 Fed. Reg. 67076, 67079.

## Suspension and Debarment (cont'd): “Knowing”

- Although the Final Rule does not define “knowing,” the Councils stated in the Preamble that “knowing” refers to the failure to disclose. Furthermore, the Preamble states that “using the standard of ‘credible evidence’ rather than ‘reasonable grounds to believe’ will help clarify ‘knowing’.” 73 Fed. Reg. 67079.
  - According to the Councils, the term credible evidence “indicates a higher standard, implying that the contractor will have the opportunity to take some time for preliminary examination of the evidence to determine its credibility before deciding to disclose to the Government.” 73 Fed. Reg. 67073.
  - The Councils rejected a “should have known” standard. 73 Fed. Reg. 67079.

## Suspension and Debarment (cont'd): Significant Overpayment

- **Proposed Rule:** The Proposed Rule contained no limitation on the scope of “overpayment” sufficient to trigger suspension/debarment.
- **Final Rule:** The suspension and debarment provisions apply to “Significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments as defined in 32.001.” FAR 9.406-2(b)(1)(vi)(C), 9.407-2 (a)(8)(iii).
- **Preamble:** The Councils limited the suspension and debarment provisions of the final rule to “significant overpayments, which implies more than just dollar value and depends on the circumstances of the overpayment as well as the amount.” Whether an overpayment is significant is within the discretion of the suspension and debarment official.

Note that there is no requirement under the mandatory disclosure provisions to disclose “significant overpayment.” The Councils concluded that contractors have a pre-existing duty to disclose overpayment under the existing payment clauses. 73 Fed. Reg. 67080.

## Duration of Disclosure Obligation

- **Proposed Rule:** The Proposed Rule was not specific regarding the duration of the disclosure requirements.
- **Final Rule:** Councils agreed to add the phrase “until 3 years after final payment on any Government contract awarded to the contractor” to the provisions for suspension and debarment at FAR 9.406–2(b)(1)(vi) and FAR 9.407–2(a)(8) and the internal control system provisions at FAR 52.203-13(c)(2)(ii)(F).
- **Preamble:** The Councils agreed that required disclosure of violations under the suspension and debarment and internal control system provisions should be limited to a period of three years after contract completion, using final payment as the event to mark contract completion. 73 Fed. Reg. 67074.

## Timely Disclosure

- **Proposed Rule:** The Proposed Rule was silent as to the meaning of “timely” disclosure under the mandatory disclosure requirement and the suspension and debarment provisions.
- **Preamble:** The Councils stated that they considered and rejected adding a fixed time period for investigation, but noted that the “credible evidence” standard implies that the contractor will have the opportunity to take some time for preliminary examination of the evidence to determine its credibility before deciding to disclose to the Government. 73 Fed. Reg. 67074.

# Timely Disclosure (cont'd): Measuring Timeliness

- **Mandatory disclosure: Prospective in application**
  - Under the revised contractual clause set forth in FAR 52.203-13, timeliness is measured from the date of determination of credible evidence or the date of contract award, whichever occurs later. 73 Fed. Reg. 67075.
  - Under the disclosure requirement of the internal control systems, timely disclosure is measured from the date of determination by the contractor that the evidence is credible, or the date of establishment of the internal control system, whichever is later. 73 Fed. Reg. 67075.
- **Suspension and Debarment**
  - Timely disclosure is measured from the date of determination by the contractor that the evidence is credible, or from the effective date of the rule, whichever occurs later. 73 Fed. Reg. 67075.
  - Preamble states that the effective date of the rules – December 12, 2008 – is the trigger for pre-existing issues.



# **Effective Compliance Programs & Risk Assessments**

# Standards for an Effective Compliance Program

## **Federal Sentencing Guidelines**

- Organizational culture and “tone at the top”
- Standards of conduct and internal controls
- Oversight and operational responsibilities of board and management
- Due diligence on background of “substantial authority personnel”
- Communication and training
- Periodic evaluation of program effectiveness, including auditing and monitoring
- Incentives to promote proper conduct and disciplinary measures for violations
- Take reasonable steps to respond to detected problems and prevent further misconduct
- Periodic risk assessments

# Conducting a Government Contracts Risk Assessment

- What are your key risk areas?
  - Where have you been the subject of government audits, investigations or enforcement actions? Private suits?
  - What are the high risk areas based on current government enforcement initiatives?
  - In what areas are your competitors subject to suits?
  - What are the emerging areas of concern? (recently filed law suits; press reports; comments by enforcement officials; Congressional hearings; etc.)

# Conducting a Government Contracts Risk Assessment (cont'd)

## ■ Risk areas

- Procurement integrity/bribery and gratuities
- Agents; contingent fees
- Revolving door restrictions
- Byrd Amendment; lobbying restrictions
- Cost, pricing and accounting
  - Defective pricing
  - Compliance with cost principles; CAS
  - Cost mischarging
- Progress/milestone payments
- Estimates to complete (ETCs)
- Content requirements
  - BAA/TAA/Berry Amendment/Specialty metals
  - New material/inventory control
  - Product substitution
- Employee qualifications
- Time charging
- Performance issues
  - Potential termination for default; show cause; cure notices
  - Past performance problems
- Compliance with specifications, quality, inspection and testing requirements
- Organizational conflicts of interest

## What to do to Comply with the New Rule – Companies with Existing Compliance Programs

- If you already have a code of conduct, business ethics and compliance program, and internal controls:
  - Identify government contracts legal risks
  - Assess applicability current FAR business ethics and compliance program, internal controls, and disclosure requirements
  - Conduct a compliance review against FAR requirements
  - Conduct a deeper dive review into policies, procedures and operational practices in identified risk areas
  - Revise and modify, as necessary, code, business ethics and compliance program and internal controls
  - Develop and implement a periodic schedule for program reviews , audits and
  - Train “principal” level personnel on mandatory disclosure requirement and establish necessary reporting and disclosure procedures
  - Ensure employment screening practices are operating as intended
  - Amend form subcontracts as necessary

## What to do to Comply with the New Rule – Companies Without an Existing Compliance Program

- If you are a federal contractor without a code of conduct, business ethics and compliance program, and internal controls:
  - Develop a corporate business ethics and compliance program and internal controls system that satisfy FAR requirements
    - Invest program resources/budget reflecting company size and business (one size does not fit all)
    - At all costs, avoid creating a “paper program”
  - Assign a high-level employee to oversee the program
  - Identify and prioritize legal risks specific to the company’s government business
  - Develop and implement an ethics and compliance awareness and training program

## What to do to Comply with the New — Companies Without an Existing Compliance Program

- Develop targeted training based on job function
- Train “principal” level personnel on mandatory disclosure requirements and establish necessary reporting and disclosure procedures
- Develop and implement employment screening practices for hiring and promotion
- Develop an ongoing monitoring system and plan for periodic reviews and audits
- Ensure “tone at the top”
- Amend form subcontracts as necessary

# **Internal Investigations & The Decision to Disclose**



# Internal Investigations

- FAR 52.203-13, Code of Business Ethics and Conduct
  - Establish procedures to facilitate timely discovery of improper conduct
  - Maintain an internal reporting mechanism, such as a hotline, for anonymous/confidential reports suspected instances of impropriety
  - Report to OIG and CO when the Contractor has “credible evidence” of civil FCA, certain crimes
- The Result: Contractor must have in place a mechanism to investigate suspected instances of wrongdoing

# What Should the Goals of the Investigation Be?

- Find out what happened
  - Determine whether there is a problem at all
  - Determine the nature and scope of any problem
  - Decide whether disclosure is required
  - Decide if remedial measures are needed to avoid recurrence

## Who Should Conduct the Investigation?

- In most cases, investigation should be conducted under the direction of lawyers:
  - Preserves the option of asserting company's attorney/client privilege
  - Investigations often involve complex legal issues
- Advantages of in-house counsel
  - More familiar with company and its culture
  - Known to management and employees
  - Less likely to disrupt operations
  - Cheaper

# Who Should Conduct the Investigation?

- Advantages of outside counsel
  - “Fresh look” at the facts
  - Employees may be more willing to share concerns about management
  - Greater credibility with the government
  - Facilitates assertion of privileges
    - Dual role of in-house counsel: business or legal advice?

## What Should Management's Role Be?

- Investigation should be independent of management control to ensure credibility
  - BUT it needs management's agreement and support
- Written agreement defining scope of engagement
  - Purpose is to provide legal advice to the company
- Management makes the ultimate decision on whether to make disclosure
  - BUT management may be within the scope of the investigation
    - Don't report to individuals who are potentially involved
    - Consider reporting to the Board of Directors or a Board committee

# How Should the Investigation be Conducted?

- Develop plan for investigation
  - Obtain “buy in” from various constituencies
- Preserve and collect documents
  - “Hard copies” of documents
  - “Soft copies” of documents
- Conduct interviews
  - Prepare standard set of opening comments
    - Who you are and what you’re doing
    - “Do I need a lawyer?”
  - Advisable to have two people participate
  - Prepare interview memoranda
    - Privilege issues
- Prepare assessment

## When Should Results Be Disclosed?

- **Recap:** FAR 52.203-13: mandatory disclosure when there's "credible evidence" of civil FCA violations, certain crimes (and "significant" overpayments, FAR 9.407-2(a)(8)).
- Cannot conduct investigation to final conclusion.
  - Preamble to Rules: "[T]he contractor will have the opportunity to take some time for preliminary examination of the evidence to determine its credibility" before making disclosure.
  - Take reasonable steps that the contractor considers sufficient to determine that the evidence is credible.
- Disclosure of civil FCA violations/crimes to CO and Inspector General
- Disclosure of significant overpayments "to the Government"

# What are the Critical Issues in Deciding Whether to Disclose?

- Innocent mistake or civil fraud/crime?
  - Credible evidence of fraudulent intent?
  - Is an overpayment “significant” or not?
    - Preamble: The standard involves more than just dollar value and depends on the circumstances of the overpayment as well as the amount.
- Contents of disclosure?
  - Simple notice or full report?
    - “May be credible evidence” or “there is credible evidence”?
  - Supporting/underlying information and materials?
- Disclose to CO or to OIG and CO?
- Continuing the investigation and updating the disclosure?



## To Whom Must the Disclosure Be Made?

- Disclosure to the agency Inspector General, with a copy to the Contracting Officer. FAR 52.203-13
  - CO is not in a position to evaluate individual employees' potentially criminal behavior – better suited to IG
- For violations relating to multiple contracts, disclosure to the agency Inspector General and Contracting Officer responsible for the largest dollar value contract impacted by the violation.
- For violations relating to multi-agency contracts, disclosure to OIG of the ordering agency and OIG of the agency responsible for the basic contract.

## How Do I Make a Disclosure?

- Disclose facts
- Avoid characterizations and admissions
- Explain timing of disclosure
- Err on side of disclosure – there is no track record on what is “credible evidence” or on what is “timely” or on what makes an overpayment “significant”
- Demonstrate a culture of compliance
  - Proactive approach to problems
  - Non-retaliatory environment
  - Show the solution/why this will not happen again
- Demonstrate candor

## Do I Have to Disclose Privileged Material?

- Whose Privilege Is It and Which Privileges Apply?
- Nothing in the new rules requires a waiver of attorney-client privilege
  - Investigation to determine whether there is credible evidence may be conducted by counsel and can be protected
    - Underlying facts are not protected, but the investigation may be
    - Will the investigation report be disclosed anyway?
- Full cooperation requirement in Code of Ethics does not require waiver of privilege

## What Happens After the Disclosure?

- Upon receipt of disclosure is of possible contractor violation of federal criminal law, as defined, then Contracting Officer must
  - Coordinate the matter with the OIG
  - Take action “in accordance with agency procedures”
- Impact on status as responsible contractor
- Impact of past performance evaluation
  - Must be able to demonstrate a satisfactory record of performance, including a record of integrity and business ethics
  - In making disclosure, contractor should consider adding narrative that demonstrates record of integrity and business ethics

# What Happens After the Disclosure?

- Debarment or Suspension
  - Upon preponderance of the evidence, knowing failure to timely disclose
    - Violation of federal criminal law
    - Violation of civil False Claims Act
    - Significant overpayment
- Suspension and debarment not intended to be punitive – supposed to protect government from non-responsible contractors, SO
  - Disclosure can still be a mitigating factor
  - In disclosing, contractor should explain why it is still a responsible contractor

# Questions?

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