

The FAR Mandatory Disclosure Rules— You Do Not Have the Right to Remain Silent

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Embarrassed and outraged by recent headlines of allegations of contractor fraud—from Darlene Druyun to Duke Cunningham to the numerous cases related to the wars and reconstruction work in Afghanistan and Iraq—the Department of Justice (“DOJ”) and Congress have successfully pushed for sweeping regulatory changes within the federal procurement system. The DOJ’s and Congress’s efforts have culminated in a final rule, issued on November 12, 2008, by the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (“Councils”), amending the Federal Acquisition Regulation (“FAR”) to require contractors to self-disclose credible evidence of certain violations of law and significant overpayments in connection with the award or performance of a federal contract or subcontract.¹

As the Councils recognized, the new FAR mandatory disclosure rules are a “sea change” and “major departure” from the former carrot-and-stick approach of voluntary disclosure.² In moving closer to a stick-only approach, the government has largely ignored or discounted the great strides that contractors have made in voluntarily uncovering and disclosing wrongdoing. This article describes the new regulatory requirements, implementation issues that remain unclear, and changes to existing codes of conduct and internal control systems that contractors should consider.

I. BACKGROUND

On May 23, 2007, the DOJ proposed to the Office of Federal Procurement Policy mandatory disclosure provisions for government contractors.³ The DOJ expressed frustration that Defense Department contractors were not keeping pace with other industries in terms of self-governance:

[T]he 1980s witnessed significant innovations in the federal procurement system. Many of those reforms, including corporate compliance programs and corporate self-governance, were adopted with industry cooperation, and were later incorporated into evolving regulatory schemes in other business sectors and industries. In fact, the U.S. Sentencing Guidelines’ treatment of corporations, adopted in 1991, borrowed heavily from the reforms that were first instituted for government contractors in 1986. However, since that time, our government’s expectations of its contractors have not kept pace with reforms in self-governance in industries such as banking, securities, and healthcare.⁴

In response, on November 14, 2007, the Councils issued the first of two proposed rules, both

of which resulted in numerous public and agency comments.⁵

The first proposed rule sought to create two new causes for suspension and debarment—failures to disclose: (1) an overpayment on a government contract; or (2) a violation of Federal criminal law in connection with the award or performance of any government contract or subcontract.⁶ The first proposed rule also sought to require a new contract clause for contracts exceeding \$5 million that would require contractors to make a disclosure to the Office of the Inspector General (“OIG”) and to the contracting officer when the contractor has “reasonable grounds to suspect a violation of criminal law in connection with the award or performance of the contract or any subcontract thereunder.”⁷ In addition, the contract clause would mandate “[f]ull cooperation with any Government agencies responsible for audit, investigation, or corrective action.”⁸ The Councils proposed to except commercial item contracts and contracts “performed entirely outside the United States” from the proposed contract clause.⁹

The second proposed rule was issued on May 16, 2008, and proposed to add a third new cause for suspension and debarment—failure to disclose violations of the civil False Claims Act (“FCA”) “in connection with the award of any Government contract or subcontract.”¹⁰ The second proposed rule also sought to extend applicability of the proposed new contract clause to be included in contracts and subcontracts that are to be performed outside the United States and for commercial items.

On June 30, 2008, just six weeks after the Councils issued their second proposed rule, Congress passed the Close the Contractor Fraud Loophole Act, which required that the FAR be amended within 180 days to “require timely notification by Federal contractors of violations of Federal criminal law or overpayments in connection with the award or performance of covered contracts or subcontracts, including those performed outside the United States and those for commercial items.”¹¹ The Act defined a covered contract as

any contract greater than \$5 million and greater than 120 days in duration.¹²

In compliance with the Act, the Councils issued a final rule on November 12, 2008, with an effective date of December 12, 2008.¹³ A lengthy “preamble” summarizing public comments was published with the final rule and provides significant insight into the rationale behind certain new requirements.

II. OVERVIEW OF THE MANDATORY DISCLOSURE REQUIREMENTS

Although the new mandatory disclosure requirements are often referred to and discussed in a singular context, they are two distinct sets of requirements, one involving disclosures under revised suspension and debarment regulations, and another involving disclosures under a new contract clause.

A. Suspension and Debarment Disclosure Requirement

Suspension and debarment are two of the government’s most effective enforcement tools. These tools are not meant as a means of punishment, but rather to prevent those the government believes lack “present responsibility” from doing business with the government.¹⁴ Because of the dire consequences associated with suspension and debarment—ineligibility to perform new work under federal contracts, grants and cooperative agreements—either is often the equivalent of a “death sentence” to a government contractor.¹⁵

The FAR sets forth the circumstances, or causes, for which the government has authority to suspend¹⁶ or debar¹⁷ a contractor. As amended, the FAR now provides that a contractor may be suspended or debarred for:

Knowing failure by a **principal**, until 3 years after **final payment** on any Government contract awarded to the contractor, to **timely** disclose to the Gov-

ernment, in connection with the award, performance, or closeout of the contract or subcontract ... **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 (31 U.S.C. 3729-3733); or (C) **Significant** overpayment(s) on the contract, other than overpayments resulting from contract financing payments as defined in 32.001.¹⁸

Under the new regulations, a contractor's responsibilities now expressly provide that the knowing failure of a contractor's principals to timely disclose credible evidence of a Federal criminal violation, an FCA violation or a significant overpayment are causes for suspension and debarment.

1. Retroactive Disclosure Required

Significantly, the suspension and debarment disclosure requirements not only cover prospective violations and overpayments, but also cover violations and overpayments that occurred prior to December 12, 2008, on all contracts that are either open or that had final payments after December 12, 2005. Many of those who commented on the proposed rules argued vehemently that disclosures should only relate to prospective conduct, but the Councils disagreed, responding that “[t]he laws against these violations were already in place before the rule became effective.”¹⁹

While the disclosure requirements are not without a time limit because they require disclosure only until three years after final payment, determining the date of “final payment” is not necessarily clear. This is the case, for example, in the context of flexibly priced contracts

that are subject to final rate agreements which may not be agreed upon for many years. In addition, while FAR provision 4.804, titled “Closeout of Contract Files,” requires contracting officers to provide contactors with a “Contractor Completion Statement” that includes the number of the final payment voucher and is meant to constitute the final payment, these Statements are often overlooked by contracting officers and almost never provided. As the actual date of a “final payment” is not always clear, contractors need to choose an appropriate period of time to collect and retain information that may be subject to retroactive disclosure.

2. Consequences of Non-Disclosure Triggered By What a “Principal” Knows

Under the final rule, non-disclosure of credible evidence of covered violations and significant overpayments constitutes cause for suspension or debarment only if a principal had knowledge of such evidence.²⁰ A principal is defined as “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).”²¹ Without a doubt, there will be disputes regarding whether certain employees qualify as “principals” under this definition. As the Councils stated in the preamble, however, the definition of a “principal” should be “interpreted broadly, and could include compliance officers or directors of internal audit, as well as other positions of responsibility.”²² Given the broad scope of the definition, and the uncertainty of who will be deemed to be a principal, it is important for each contractor to widely

educate and train its management on their obligations under these new regulations.

B. Contract Clause Disclosure Requirement

In addition to subjecting contractors to new causes for suspension and debarment, the final rule also implements a new contract clause. Like the suspension and debarment disclosure requirement, the contract clause—FAR 52.203-13—requires, *inter alia*, that contractors disclose credible evidence of violations of certain Federal criminal laws and the FCA. Contractors must also have a written code of business ethics and conduct, and have in place an ethics awareness and compliance program and internal control system.²³ This contract clause will be mandatory in all “covered” contracts issued on or after December 12, 2008. A “covered” contract is any contract that has a value of \$5M or greater, and a performance period of greater than 120 days. In determining the value of the contract, option years must be included.²⁴ While the contract clause is not effective for new task or delivery orders issued under existing contracts, contractors need to be alert should the government attempt to add the clause by contract modification.

The new contract clause provides that:

The Contractor shall timely disclose, in writing, to the agency Office of the Inspector General (OIG), with a copy to the Contracting Officer, whenever, in connection with the award, performance, or closeout of this 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 found in Title 18 of the United States Code; or

- (B) A violation of the civil False Claims Act (31 U.S.C. [§§] 3729-3733).²⁵

While the disclosure requirements, at first glance, appear to mirror the disclosure requirements associated with suspension and debarment, there are some subtle differences that should be noted. Chief among the differences is that the contract clause states explicitly to whom the disclosure shall be made—the agency OIG and the contracting officer.²⁶ Violations that occur with respect to government-wide acquisition contracts, multi-agency contracts or multiple-award schedule contracts should be disclosed to the OIG of the ordering agency and the OIG of the agency responsible for the basic contract.²⁷ If a violation spans several different contracts, a contractor can satisfy its disclosure requirements under the contract clause by making a disclosure to the agency OIG for the largest dollar value contract impacted.²⁸ In contrast, under the threat of suspension and debarment, the rule simply provides that disclosure is to be made “to the Government.”²⁹

Another difference is the scope of conduct to be disclosed. Specifically, a contractor subject to the contract clause has to disclose credible evidence of any pertinent violations committed by “a principal, employee, agent, or subcontractor” that occurs “in connection with the award, performance, or closeout” of the contract.³⁰ In contrast to the new causes for suspension and debarment, the contract clause appears to impose the burden of supervising agents (defined as “any individual, including a director, an officer, an employee, or an independent Contractor, authorized to act on behalf of the organization”³¹) and subcontractors. The potential scope under the definition of agent, alone, is enormous and may implicate teaming partners, joint venture partners, and marketing consultants if they have the authority to act on behalf of the contractor.

The contract clause does not contain a provision for the disclosure of significant overpayments. In explaining this difference, the Councils noted that several other FAR provisions exist which already

mandate the disclosure of overpayments—e.g., FAR 52.232-25, FAR 52.232-26, FAR 52.232-27 and FAR 52.212.³² For example, FAR 52.212-4, titled “Contract Terms and Conditions for Commercial Items,” provides that “[i]f the Contractor becomes aware of a duplicate contract financing or invoice payment or that the Government has otherwise overpaid on a contract financing or invoice payment, the Contractor shall immediately notify the Contracting Officer and request instructions for disposition of the overpayment.”³³ Accordingly, placing a disclosure obligation in 52.203-13 for significant overpayment would be redundant and unnecessary, according to the Councils.³⁴

Finally, it is important to note that although the contract clause does not require retroactive disclosure, the new suspension and debarment regulations may. As the Councils made clear in the preamble to the final rule:

If violations relating to an ongoing contract occurred prior to the effective date of the rule, then the contractor must disclose such violations, *whether or not the clause [FAR 52.203-13] is in the contract* and whether or not an internal control system is in place, because of the cause for suspension and debarment in Subpart 9.4.³⁵

Moreover, as discussed below, the new contract clause requires the establishment of an internal control system that would provide for such retroactive disclosures.

1. Business Ethics Awareness and Compliance Program and Internal Control System

Under the contract clause, contractors have a duty to have in place a business ethics awareness and compliance program and internal control system within 90 days of receiving a covered contract award.³⁶ The clause also requires that a contractor’s internal control system have

specific components that relate to the mandatory disclosure requirements.³⁷ For example, a contractor’s internal control system should “[e]stablish standards and procedures to facilitate timely discovery of improper conduct in connection with Government contracts.”³⁸ Of course, upon discovering credible evidence of violations of Federal criminal law involving fraud, gratuities, or conflicts of interests in Title 18, or violations of the civil False Claims Act, the contractor would have an obligation to report these to the agency OIG and contracting officer. In fact, the contract clause expressly provides that a contractor’s internal control systems must provide for timely disclosures of these violations in connection with “any” government contract, not just those contracts containing the new clause.³⁹ The requirements for the code of business ethics and conduct and internal control systems are discussed further in Section V, *infra*.

2. Mandatory Flowdown to Subcontracts

FAR 52.203-13 is a mandatory clause for covered prime contracts. Additionally, the substance of FAR 52.203-13 must be inserted in any “covered subcontract” issued under the prime contract.⁴⁰ A subcontract is defined under the clause as “any contract entered into by a subcontractor to furnish supplies or services for performance of a prime contract or subcontract.”⁴¹ A subcontractor is defined as “any supplier, distributor, vendor, or firm that furnished supplies or services to or for a prime contractor or another subcontractor.”⁴² As with prime contracts, a “covered” subcontract is a subcontract that has a value of greater than \$5M (including option periods) and has a performance

period of greater than 120 days.⁴³ Since the clause is mandatory in covered subcontracts, subcontractors are required to include it in any lower-tier subcontracts that are issued.

III. WHAT NEEDS TO BE DISCLOSED?

The new regulations provide that the information to be disclosed is “credible evidence” of a violation. There is no requirement that a contractor admit to liability for any violations or overpayments. The types of matters to be reported can be classified in three categories as violations of certain Federal criminal law, violations of the False Claims Act and significant overpayments.⁴⁴ Each of these categories is explored in greater detail below.

A. Violations of Federal Criminal Law

While the new regulations limit the relevant criminal laws to those within Title 18—and exclude, therefore, other criminal laws such as the Anti-Kickback Act of 1986, 41 U.S.C. § 51 *et seq.*—they do not enumerate the covered violations other than to describe them as those that involve “fraud, conflict of interest, bribery, or gratuity violations.”⁴⁵

The first type of violation identified in the rule, fraud, is referenced more than 100 times in Title 18 and could subject a contractor to make a disclosure with respect to each instance if the potential violation is “in connection with the award, performance, or closeout of the contract or subcontract.”⁴⁶ The Title 18 provisions that are most likely to require disclosure if violated are § 287 (False, Fictitious or Fraudulent Claims) and § 1031 (Major Fraud Against the United States). However, given the government’s expansive use of other statutes in prosecuting contractor fraud, many other provisions are potentially applicable, including § 1001 (Fraud and False Statements), § 1341 (Mail Fraud), § 1343 (Wire Fraud), § 1346 (Honest Services Fraud).

The second type of Federal criminal law violation identified—conflict of interest—is referenced

in several places in Title 18, including 18 U.S.C. § 203, 18 U.S.C. § 205, and 18 U.S.C. §§ 207-209. These types of violations may not always be immediately clear and are briefly discussed here. Specifically, 18 U.S.C. § 203 generally prohibits any federal employee from receiving “compensation for any representational services” rendered “personally or by another” before a federal agency or court with respect to any proceeding in which the United States is a party or has a direct and substantial interest. Section 205 prohibits federal employees from acting as agents or attorneys for any individual or entity (other than a labor organization) before any federal agency with respect to any matter where the United States is a party or has a direct and substantial interest. Known as the “Revolving Door Restrictions,” 18 U.S.C. § 207 places restrictions on activities that Federal government employees can perform for a certain time after leaving their government employment. Additionally, 18 U.S.C. § 208 places restrictions on Federal government employees in “participating personally and substantially” with matters in which they might have a financial interest. Furthermore, under 18 U.S.C. § 209, Federal government employees can only receive compensation for their services from the government.

The most likely provisions relating to the third and fourth categories—bribery and gratuity violations—are both found in 18 U.S.C. § 201.

B. Violations of the Civil False Claims Act

In addition to Federal criminal law violations, contractors are also required to disclose credible evidence of violations of the civil False Claims Act. This disclosure requirement presents special challenges to contractors because of conflicting interpretations of the False Claims Act among the circuit courts. The Councils acknowledge, though, 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.”⁴⁷ The Councils also recognize that “the mere filing of a *qui tam* action . . . is not sufficient to establish

a violation under the statute, nor does it represent standing alone, credible evidence of a violation.”⁴⁸

C. Significant Overpayments

In addition to Federal criminal law violations and civil False Claims Act violations, contractors, under the final rule, are also required to disclose credible evidence of “significant overpayments.” This duty arises from the threat of suspension and debarment and not under FAR 52.203-13. The rule fails to define what a significant overpayment is, but does exclude certain types of payments. Specifically, the following types of payments from FAR Part 32,⁴⁹ do not fall under the purview of the disclosure requirement: advance payments; performance-based payments; commercial advance and interim payments; progress payments based upon costs; progress payments based upon percentage/stage completion; and interim payments under a cost reimbursement contract (except when the contract is for services and Alt. I of FAR clause 52.232-25, titled “Prompt Payment,” is used).

IV. MIND THE GAP BETWEEN THE RULE AND UNRESOLVED ISSUES

While the rule purports to make clear when disclosure is required, the line is not so bright when closely examined. There are many open issues which will, as a result, undoubtedly create angst among contractors because of the severe penalties for non-compliance.

A. Timely and Credible Evidence

While it is clear that contractors are required to make a “timely disclosure” of violations, the rule fails to provide a definition of “timely.” The preamble addresses this issue for both the cause for suspension and debarment and contract clause. Specifically, “timely disclosure of credible evidence as required by the rule as cause for suspension or debarment would be measured from the

date of determination by the contractor that the evidence is credible, or from the effective date of the rule, whichever event occurs later.”⁵⁰ Timeliness for contractual purposes is measured by the later of the date a contractor determines that there is credible evidence of a violation; the date the contract clause was incorporated into a contract; or the date that the contractor’s internal control system was established.⁵¹

Clearly, the Councils intended the meaning of “timely” to be intertwined with when the contractor determines that there is—or is not—“credible evidence” of a violation. However, this standard is of little value because the standard of what constitutes “credible evidence” is not itself a bright line.⁵² While the rule itself fails to define “credible evidence,” the definition of “credible information” contained in the Defense Federal Acquisition Regulation Supplement may provide some guidance as to how “credible evidence” will be defined. “Credible information” is defined in DFARS 252.246-7003 as “information that, considering its source and the surrounding circumstances, supports a reasonable belief that an event has occurred or will occur.”⁵³ In making such an evaluation, a contractor is allowed to consider the legal elements comprising a violation, as well as possible defenses and judicial opinions, including conflicts between different courts on the elements of the violation in question.⁵⁴

B. Significant Overpayment

Another key phrase that lacks a definition is “significant overpayment.” Under the new causes for suspension and debarment, a contractor must disclose “to the Government” credible evidence of a significant overpayment by the government. The Councils agreed with respondents that the sanction of suspension or debarment for failing to disclose overpayments should be limited to “significant” overpayments, which “implies more than just dollar value and depends on the circumstances of the overpayment as well as the amount.”⁵⁵ The drafters also explained that:

Since contracts are required by the Payment clauses [in the FAR] to report and return overpayments of any amount, it is within the discretion of the suspension and debarment official to determine whether an overpayment is significant and whether suspension or debarment would be the appropriate outcome for failure to report such overpayment.⁵⁶

While the suspension and debarment official has discretion in determining what actually constitutes a significant overpayment, there is no indication on the limits of that discretion or whether they must apply some materiality threshold.

As such, in evaluating whether an overpayment may be significant in determining whether or not to disclose it, a contractor should not look at just the amount of the overpayment. Rather, the contractor should consider the cause of the overpayment, especially any actions on the part of the contractor that precipitated the overpayment.

C. Who Receives the Disclosures Made Under the Threat of Suspension and Debarment?

In contrast to the contract clause, the causes that give rise to suspension or debarment for failing to disclose violations do not have to be disclosed to any particular entity or individual. Rather, disclosure is to be made to “the Government.”⁵⁷ Furthermore, this disclosure does not have to be in writing. Since there are many facets to the government, it begs the question as to whether a contractor could satisfy the disclosure requirement by making a disclosure to its mail man. While disclosure to the mail man is clearly inadequate, the rule’s ambiguity opens the door to contractors making strategic disclosures.

Perhaps the “safest” option would be to make the disclosure in writing to the contracting officer and to the OIG, as would be required under the contract clause. This is not required under the suspension and debarment disclosure requirements, however, and there are a plethora of reasons as to why such a disclosure is unattractive. Another

option might be to make a disclosure only to the contracting officer. This would likely satisfy the contractor’s requirements under the disclosure rule and simultaneously put the burden on the government to act further if it determines further action is warranted. However, it might not satisfy the internal control system requirements under the new contract clause.

V. CODES OF CONDUCT, COMPLIANCE PROGRAMS AND INTERNAL CONTROL SYSTEMS

In addition to impacting disclosure requirements, the contract clause also contains requirements for a contractor’s code of business ethics and conduct, compliance program and internal control system. These requirements are “generally consistent” with the United States Sentencing Guidelines (“USSG”) and the FAR Council believes that by adhering to these requirements, “contractor[s] should be in a better position if accused of a crime.”⁵⁸

A. Codes of Business Ethics and Conduct

Under FAR 52.203-13, contractors performing covered contracts⁵⁹ are required to have a written code of business ethics and conduct.⁶⁰ Contractors are required to make this code of conduct available to every employee performing the covered contract.⁶¹ In light of the final rule, contractors should examine their codes of conduct. While codes of business ethics and conduct are only required for covered contracts by the final rule, it is prudent for all government contractors to have one in place. Codes of business ethics and conduct are also important in the eyes of the FAR Council because they provide “a basis for evaluating the firm’s responsibility, including special standards of responsibility when appropriate ... [and] also [provide] a basis for internal policy development ... [a]nd when something goes wrong, the code is meaningful for enforcement and for understanding and perhaps incorporating lessons learned.”⁶²

Of course, the first thing that contractors should ensure is that their codes are in writing, as required. Second, contractors should have a uniform method for distributing the code to every employee. One example would be for the contractor to provide a code to every new employee at training and to every existing employee at a specially designated meeting. A contractor could also require each employee to sign an acknowledgement form at the back of the code that states he or she has read the code, understands it, and intends to comply with it. Contractors have flexibility in how they distribute the code of business ethics and conduct, and electronic delivery, such as a link to a website with the code, is permitted under the rule.⁶³

Codes of business ethics and conduct tend to vary significantly in nature depending on companies and industries. However, in light of the final rule, there are several, generic points that all contractors should consider, including whether to reiterate every employee's obligation to disclose suspected violations of any company policies or laws in every instance to their appropriate supervisor, management or a compliance officer. The code should reflect that internal reporting is important because it is the right thing to do and is in line with the culture of the company.

To this end, the code should clearly articulate steps for an employee to take if he or she uncovers or suspects a violation of any applicable laws or company policies, such as which individuals within a company can receive such a report. By way of example, many companies currently require employees to report suspected violations to the internal compliance officer or to the legal department all potential violations of law, regulation, or company policy. An important point to remember is that in reporting things internally, employees are not making a determination of what needs to be ultimately disclosed to the government. That decision should rest with the leadership of the company, such as the principals, in consultation with legal counsel.

B. Compliance Program and Internal Control System

In addition to a written code of business ethics and conduct, the final rule requires a business ethics awareness and compliance program and internal control system.⁶⁴ Specifically, the clause provides that within 90 days after being awarded a covered contract, a contractor is required to put in place an ongoing business ethics awareness and compliance program.⁶⁵ The program is required to contain:

[S]teps to communicate periodically and in a practical manner the Contractor's standards and procedures and other aspects of the Contractor's business ethics awareness and compliance program and internal control system, by conducting effective training programs and otherwise disseminating information appropriate to an individual's respective roles and responsibilities.⁶⁶

As with codes of business ethics and conduct, business ethics awareness and compliance programs and internal control systems vary significantly depending on the company. However, the contract clause itself contains minimum requirements for a contractor's internal control system. It is worth noting that while the USSG serves as the "source of the FAR text ... the FAR text is intentionally not adopting [the USSG] verbatim."⁶⁷

1. Internal Control System Requirements

The requirements in the FAR text are:

- (A) Assignment of responsibility at a sufficiently high level and adequate resources to ensure effectiveness of the business ethics awareness and compliance program and internal control system.

- (B) Reasonable efforts not to include an individual as a principal, whom due diligence would have exposed as having engaged in conduct that is in conflict with the Contractor's code of business ethics and conduct.
- (C) Periodic reviews of company business practices, procedures, policies, and internal controls for compliance with the Contractor's code of business ethics and conduct and the special requirements of Government contracting, including—
 - (1) Monitoring and auditing to detect criminal conduct;
 - (2) Periodic evaluation of the effectiveness of the business ethics awareness and compliance program and internal control system, especially if criminal conduct has been detected; and
 - (3) Periodic assessment of the risk of criminal conduct, with appropriate steps to design, implement, or modify the business ethics awareness and compliance program and the internal control system as necessary to reduce the risk of criminal conduct identified through this process.
- (D) An internal reporting mechanism, such as a hotline, which allows for anonymity or confidentiality, by which employees may report suspected instances of improper conduct, and instructions that encourage employees to make such reports.
- (E) Disciplinary action for improper conduct or for failing to take reasonable steps to prevent or detect improper conduct.⁶⁸

These minimum requirements are very specific and the first step a contractor should consider is training all of its employees on its business ethics standards and procedures as part of its overall ethics awareness and compliance program. This training should be provided to all of a contractor's employees, including all of the contractor's principals.⁶⁹ Additionally, contractors may want to consider training agents and subcontractors that frequently work with the contractor or that are handling large portions of a Federal contract.⁷⁰

2. Practical Considerations in Tailoring Internal Control Systems

Contractors will also have to decide how to tailor their internal control systems to satisfy each of the minimum requirements. For example, the first requirement states that a contractor's internal control system should "[e]stablish standards and procedures to facilitate timely discovery of improper conduct in connection with Government contracts."⁷¹ Such standards and procedures would likely differ significantly between a contractor that performs construction and another that provides document management services.

A required starting point is for a contractor to conduct a "risk assessment" that determines what type of improper conduct is likely to occur in connection with a government contract—or rather, what is required such as compliance with cost principles. The risk assessment is at the heart of a company's compliance program and needs to take into account many factors, including the nature of the business and the nature of government contracts performed.

The minimum requirements also impose a duty on contractors to "check out" potential principals. Specifically, contractors shall take "[r]easonable efforts not to include an individual as a prin-

principal, whom due diligence would have exposed as having engaged in conduct that is in conflict with the Contractor's code of business ethics and conduct."⁷² The clause gives no guidance as to what would constitute due diligence for purposes of this requirement. Therefore, before any individual is added as a principal, it would be prudent for a contractor to employ a series of checks that are intended to probe an individual's reputation for honesty and integrity. Some of the different steps that a contractor could employ include checking the government's suspension and debarment list, performing a criminal background check, and verifying references provided.

Another key requirement mandates that contractors have internal reporting mechanisms that allow for anonymous reporting.⁷³ To comply with this requirement, contractors should designate or hire a compliance officer whose job it is to receive reports. Furthermore, the compliance officer must be provided with a mechanism, such as a specially designated phone number or drop box, that would allow individuals to communicate with the compliance officer in an anonymous fashion, if desired.⁷⁴

3. What it Means to Fully Cooperate

While having an internal control system requirement regarding disclosures may not be surprising given the disclosure requirements that are now peppered throughout the FAR, the contract clause also mandates that contractors pledge their "[f]ull cooperation with any Government agencies responsible for audits, investigations, or corrective actions."⁷⁵ Full cooperation is defined as "disclosure to the Government of the information sufficient for law enforcement to identify the nature and extent of the of-

fense and the individuals responsible for the conduct. It includes providing timely and complete response to Government auditors' and investigators' request for documents and access to employees with information."⁷⁶ Also troubling is the Councils' view that "compliant contractors will encourage employees to both make themselves available and to cooperate with the Government investigation."⁷⁷

Given the many concerns expressed regarding the potential encroachment into privilege issues, the final rule provides that full cooperation:

Does not foreclose any Contractor rights arising in law, the FAR, or the terms of the contract. It 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.⁷⁸

This provision, however, is seemingly in tension with the Councils' stated intention that "cooperation should include all information requested as well as all pertinent information known by the contractor necessary to complete the investigation, whether the information helps or hurts the contractor."⁷⁹ Given the Councils' statement that "facts are never protected,"⁸⁰ it is unclear, for example, whether the Councils believe that the statement of a witness to counsel must be disclosed.

VI. FOIA ISSUES

The contract clause recognizes that disclosures under the contract clause may contain information that is confidential or proprietary to the contractor. Therefore, to safeguard the information, the government will not, “to the extent permitted by law and regulation,” release such information under the Freedom of Information Act (“FOIA”)⁸¹ if the information disclosed is marked “confidential” or “proprietary” prior to notifying the contractor.⁸² In protecting material from disclosure under FOIA, the government is likely to invoke either the (b) (4) or (b)(7) exemptions.⁸³ Under FOIA exemption (b)(4), the government can withhold from release “trade secrets and commercial or financial information obtained from a person and privileged or confidential.”⁸⁴ FOIA exemption (b)(7) allows the government to withhold from release “records or information compiled for law enforcement purposes.”⁸⁵

The government retains the authority to invoke the (b)(7) exemption and a contractor making disclosures to the government may not know whether or not the government will invoke this exception. However, by marking documents “confidential” and/or “proprietary,” the government is placed on notice that it cannot release the information under FOIA without allowing the contractor to comment on the releasability of the disclosed information.⁸⁶ While the government may have restrictions on its ability to release disclosed information to the general public, it does have the authority to transfer any disclosed information to any other Executive Branch agencies if the information disclosed relates to matters that fall under another agency’s purview.⁸⁷ As such, it is very important for contractors disclosing information to mark each page disclosed as being either “confidential” or “proprietary” so as to minimize the chances of that information being released into the public domain.

VII. CONCLUSION

The final rule contains sweeping changes that impose new and onerous burdens on Federal government contractors. Contractors are now required to timely disclose to the government credible evidence of violations of Federal criminal law, violations of the civil False Claims Act and significant overpayments. Failing to do so can result in the suspension or debarment of a contractor. In many respects, however, the final rule is ambiguous as to what needs to be disclosed, to whom the disclosure must be made, and when it must be made.

Given the broad scope of the final rule, it is important that contractors examine their procedures and standards as soon as possible and prepare to make any disclosures required by the rule. While it remains to be seen how the government handles the unknowns and the ambiguous aspects of the rule, one thing is certain—inaction is no defense.

ENDNOTES

1. Contractor Business Ethics Compliance Program and Disclosure Requirements, 73 Fed. Reg. 67,064 (Nov. 12, 2008) (to be codified at 48 C.F.R. pts. 2, 3, 9, 42 and 52).
2. *Id.* at 67,069.
3. Letter from Alice Fisher, Assistant Attorney General, Criminal Division, Department of Justice, to Paul Denett, Administrator, Office of Federal Procurement Policy, OMB (May 23, 2007), available at <http://www.usdoj.gov/criminal/npftf/pr/statements/2007/may/05-23-07chnng-far-propose.pdf>.
4. *Id.*
5. Contractor Compliance Program and Integrity Reporting, 72 Fed. Reg. 64,019 (proposed)

Nov. 14, 2007) (to be codified at 48 C.F.R. pts. 3, 9, 42 and 52).

6. *Id.*

7. *Id.*

8. *Id.* at 64,023.

9. *Id.* at 64,020.

10. Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. 28,407 (proposed May 16, 2008) (to be codified at 48 C.F.R. pts. 3, 9, 42 and 52).

11. Pub. L. No. 110-252, § 6102, 122 Stat. 2323, 2386 (2008).

12. Section 6103 of the Close the Contractor Fraud Loophole Act.

13. Contractor Business Ethics Compliance Program and Disclosure Requirements, 73 Fed. Reg. 67,064 (Nov. 12, 2008) (to be codified at 48 C.F.R. pts. 2, 3, 9, 42 and 52).

14. See 48 C.F.R. Part 9. Suspension is a “serious action” that is imposed on a contractor “pending the completion of [an] investigation or legal proceeding, when it has been determined that immediate action is necessary to protect the Government’s interests.” *Id.* at § 9.407-1(b)(1). Debarment is another serious action that the government can take against a contractor to protect its interests. See *Id.* at § 9.406-1. While a suspension prevents a contractor from receiving contracts during the pendency of an investigation or legal proceeding, a debarment has the effect of barring a contractor from receiving a Federal contract for an extended period of time, usually from three years to five years. *Id.* at § 9.406-4.

15. *But see id.* at § 9.405 (explaining that an agency head or designee can state compelling reasons that would justify continued business with the suspended contractor by that agency).

16. *Id.* § 9.407-2 (describing the causes for suspension).

17. *Id.* at § 9.406-2 (describing the causes for debarment).

18. *Id.* at §§ 9.406-2 and 9.407-2 (emphases added).

19. Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. at 67,074.

20. See 48 C.F.R. §§ 9.406-2 and 9.407-2.

21. *Id.* at § 2.101(b)(2).

22. Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. at 67,079.

23. 48 C.F.R. § 52.203-13. Note however, that the requirement regarding an ethics awareness and compliance program and internal control system does not apply to small business concerns or commercial item contracts.

24. Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. at 67,085.

25. 48 C.F.R. § 52.203-13(b)(3)(i).

26. *Id.* at § 52.203-13(b)(3).

27. *Id.* at § 52.203-13(b)(3)(iii).

28. *Id.* at § 52.203-13(c)(2)(ii)(F)(1).

29. See discussion Part IV.C *infra*.
30. 48 C.F.R. § 52.203-13(b)(3)(i).
31. *Id.* at § 52.203-13(a).
32. Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. at 67,080.
33. 48 C.F.R. § 52.212-4.
34. See Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. at 67,079-80 (explaining the existing duties under the FAR to report overpayments).
35. *Id.* at 67,064.
36. 48 C.F.R. § 52.203-13(c).
37. *Id.* at § 52.203-13(c)(2).
38. *Id.* at § 52.203-13(c)(2)(i)(A).
39. *Id.* at § 52.203-13(c)(2)(ii)(F).
40. See *id.* at § 52.203-13(d)(1).
41. *Id.* at § 52.203-13(a).
42. *Id.*
43. *Id.* at § 52.203-13(d)(1).
44. See discussion *supra* Part II.B (explaining that the duty to report significant overpayment applies only with respect to the threat of suspension or debarment and not to the contract clause mandating disclosures).
45. 48 C.F.R. § 9.406-2(b)(1)(vi)(A); see also 48 C.F.R. § 9.407-2(a)(8)(i).
46. 48 C.F.R. § 9.406-2(b)(1)(vi); see also 48 C.F.R. § 9.407-2(a)(8).
47. Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. at 67,081.
48. *Id.*
49. 48 C.F.R. § 32.0001.
50. Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. at 67,075.
51. *Id.*
52. The rule's use of "credible evidence" indicates a higher standard than "reasonable grounds to believe," which was in the proposed rule. In doing so, the drafters explained that the term "credible evidence" indicated a "higher standard [than reasonable grounds to believe], 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." *Id.* at 67,073.
53. 48 C.F.R. § 252.246-7003.
54. See discussion *supra* Part III.B (discussing the different things a contractor may consider in evaluating whether there is credible evidence of a violation of the civil False Claims Act).
55. Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. at 67,080.
56. *Id.*
57. 48 C.F.R. § 9.406-2(b)(1)(vi); see also 48 C.F.R. § 9.407-2(a)(8).

58. Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. at 67,068.

59. Covered contracts are those contracts that are greater than \$5 million in value (including option years) and have a performance period of greater than 120 days.

60. 48 C.F.R. § 52.203-13(b)(1)(i).

61. *Id.* at § 52.203-13(b)(1)(ii).

62. Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. at 67,066.

63. *Id.*

64. 48 C.F.R. § 52.203-13(c).

65. *Id.* at § 52.203-13(c)(1).

66. *Id.* at § 52.203-13(c)(1)(i).

67. Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. at 67,068.

68. 48 C.F.R. at § 52.203-13(c)(2). The remaining minimum requirements are the ones requiring mandatory disclosure and full cooperation:

(F) Timely disclosure, in writing, to the agency OIG, with a copy to the Contracting Officer, whenever, in connection with the award, performance, or closeout of any Government contract performed by the Contractor or a subcontractor thereunder, the Contractor has credible evidence that a principal, employee, agent, or subcontractor of the Contractor has committed a violation of Federal criminal law involving fraud,

conflict of interest, bribery, or gratuity violations found in Title 18 U.S.C. or a violation of the civil False Claims Act (31 U.S.C. 3729–3733).

(1) If a violation relates to more than one Government contract, the Contractor may make the disclosure to the agency OIG and Contracting Officer responsible for the largest dollar value contract impacted by the violation.

(2) If the violation relates to an order against a Governmentwide acquisition contract, a multi-agency contract, a multiple-award schedule contract such as the Federal Supply Schedule, or any other procurement instrument intended for use by multiple agencies, the contractor shall notify the OIG of the ordering agency and the IG of the agency responsible for the basic contract, and the respective agencies' contracting officers.

(3) The disclosure requirement for an individual contract continues until at least 3 years after final payment on the contract.

(4) The Government will safeguard such disclosures in accordance with paragraph (b)(3)(ii) of this clause.

(G) Full cooperation with any Government agencies responsible for audits, investigations, or corrective actions.

Id.

69. See 48 C.F.R. § 52.203(c)(1)(ii) (explaining that training should include a contractor's employees).

70. See *id.*

71. *Id.* at § 52.203(c)(2)(i)(A).

72. *Id.* at § 52.203(c)(2)(ii)(B).

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73. *Id.* at § 52.203-13(c)(2)(ii)(D).
74. *Id.*
75. *Id.* at § 52.203-13(c)(2)(ii)(G).
76. *Id.* at § 52.203-13(a).
77. Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. at 67,078.
78. 48 C.F.R. § 52.203-13(a).
79. Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule), 73 Fed. Reg. at 67,078.
80. *Id.* at 67,077.
81. 5 U.S.C. § 552 *et. seq.*
82. 48 C.F.R. § 52.203-13(b)(3)(ii).
83. 5 U.S.C. §§ 552(b)(4) & (b)(7).
84. 5 U.S.C. § 552(b)(4).
85. 5 U.S.C. § 552(b)(7).
86. See Executive Order 12,600.
87. 48 C.F.R. § 52.203-13(b)(3)(ii).