

Now You Have to Tell the Government

New rules mean that federal contractors must disclose violations of certain criminal laws.

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It's a good time to be a government contractor. In today's uncertain economic climate, and with President Barack Obama set to unleash several hundred billion dollars of economic stimulus funding into the economy, more and more companies are contemplating entering the government contracting world or expanding their current business with the U.S. government.

Before diving headfirst into the federal marketplace, however, government contractors need to be aware of a recent and significant change to the business relationship between private companies and the U.S. government.

On Dec. 12, 2008, new Federal Acquisition Regulation rules on mandatory disclosure and ethics and compliance went into effect. Among other things, the rule requires government contractors to disclose evidence of violations of certain criminal laws by their employees or subcontractors and to implement certain internal controls within their companies.

Some in industry have criticized the rule as overreaching and unworkable, and they have struggled to find consistent, practical guidance for effectively implementing the various requirements.

This has especially been the case for commercial-item contractors, which sell their products in the private marketplace as well as to the federal government, and small businesses for which federal contracts may not be their main source of business. These companies may have recently expanded into the federal marketplace and may not have the proper internal controls to meet the requirements of the new rule.

Adding to the confusion, certain aspects of the rule apply only to contractors that hold "covered contracts," and there are various exceptions in place for commercial-item contractors and small business concerns—some of which have been removed in the new rule, and others of which have been added.

MANDATORY DISCLOSURE

Although the rule is wide-ranging and makes several signifi-

cant changes to the way the government will do business with contractors in the future, there are two new requirements of which contractors must be immediately aware.

The first, and most obvious, new requirement is mandatory disclosure. The new rule requires, for contracts and solicitations after the Dec. 12 effective date, the insertion of the clause at FAR 52.203-13, Contractor Code of Business Ethics and Conduct, in all contracts in which the value of the contract is expected to exceed \$5 million and the performance period is 120 days or more (a "covered contract").

Among other things, the revised version of FAR 52.203-13 requires contractors to make a timely disclosure to the agency Office of the Inspector General whenever they have credible evidence that a principal, employee, agent, or subcontractor has committed a violation of federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations in Title 18 of the U.S. Code, a violation of the civil False Claims Act, or substantial overpayments by the government in connection with the contract.

This clause will be inserted into all new and existing contracts. The rule also creates new bases for suspension and debarment from contracting because of a contractor's failure to timely disclose credible evidence of violations.

The second significant aspect of the new rule with which contractors must be familiar is the mandatory internal control system requirements. The revised version of FAR 52.203-13 now requires contractors with a covered contract to have in place a written code of business ethics and conduct, a business awareness and compliance program, and certain mandatory minimum internal controls.

Some of the more notable required internal controls include reasonable efforts not to hire or promote as a principal any person who due diligence would have exposed as having engaged in conduct that conflicts with the contractor's code of business ethics and conduct, reasonable efforts not to do business with subcontractors with poor records of business integrity and ethics, and training for subcontractors and agents "as appropriate."

The new rule eliminated the exception that previously existed for commercial-item contractors from the requirement to have a

written code of business ethics and conduct. Commercial-item contractors and small business concerns, however, are exempted from the business ethics awareness and compliance program and the internal control system requirements.

ENSURING COMPLIANCE

Although many commercial-item contractors and small businesses may already have existing mechanisms in place that are consistent with the new rule, they should nonetheless review the rule's specific requirements to ensure that their existing systems comply.

Some of the more important questions commercial-item contractors and small businesses should ask themselves to ensure compliance include:

- Do we have a written code of business ethics and conduct that addresses the company's policies in key government contracts compliance areas (e.g., gifts and gratuities, conflicts of interest, bribery)?
- Do our employees engaged in the performance of government contracts receive regular training on the policies addressed in the code of business ethics and conduct and other pertinent compliance issues?
- Do we have an internal reporting mechanism in place, such as a hot line, through which our employees can anonymously and confidentially report suspected violations, and have our employees been made aware of it during training and through the use of posters advertising the hot line?
- Have we designated a senior officer of the company (or of the division that performs government contracts) as being responsible for coordinating and overseeing internal investigations of reports of suspected violations and decision-making processes about disclosure to the government?
- Do we have formal procedures in place for documenting internal investigations and decisions to disclose or not to disclose to the government?
- Do we have human resources policies and procedures in place to conduct adequate background checks to vet current and prospective principals for hiring and promotions?
- Do we have policies and procedures in place for assessing the record of business integrity and ethics of our subcontractors and teaming partners and for verifying whether they have a compliance program and appropriate training in place?
- In the past six months, have we conducted a review of the effectiveness of our company's business practices, procedures, policies and internal controls for compliance, and have we assessed the risk of criminal conduct?

If the answer to any of the above questions is "No," the company should strongly consider taking appropriate steps to modify its business ethics and compliance programs and its internal control systems because of the new rule.

WRONG ASSUMPTIONS

The most basic mistake contractors can make is to assume that, because they do not hold a "covered contract," the requirements of the new rule will not affect their company. Alternatively, many contractors may assume that they can safely ignore certain aspects of the new rule

because of the exemptions for commercial-item contractors and small businesses.

From both a legal and practical perspective, these assumptions are incorrect.

With respect to the mandatory disclosure requirement, although it is true that FAR 52.203-13 will be inserted only into contracts expected to exceed \$5 million and 120 days, the new bases for suspension and debarment established in the new rule exist independent of the clause at FAR 52.203-13, and they apply to all contractors. Thus, commercial-item contractors and small businesses can be suspended and debarred if they knowingly fail to disclose to the government credible evidence of certain violations, even if they do not hold a "covered contract."

Commercial-item contractors and small businesses are specifically exempted from the requirements in the new rule relating to a business ethics awareness and compliance program and internal control system, but they still would be wise to pay close attention to these requirements and consider adopting them anyway.

As an initial matter, many of the minimum internal controls established in the new rule are necessary to ensure compliance with the mandatory disclosure requirement. Without (1) proper compliance training for employees, (2) effective internal reporting mechanisms for reporting suspected instances of improper conduct, and (3) established procedures for centrally collecting reports of misconduct, for conducting internal investigations, and for making credible evidence determinations, contractors cannot effectively ensure compliance with the requirement to timely disclose credible evidence of violations.

Moreover, the mandatory minimum internal controls established in FAR 52.203-13 may, as a practical matter, become the de facto standard of reasonableness for all contractors—regardless of whether they are exempted from certain requirements.

Thus, in the event a company is accused of failing to discover or disclose evidence of a suspected violation, government investigators will almost assuredly look first to see what whether the company has appropriate internal procedures in place for communicating its business ethics and conduct standards to its employees, for reporting suspected violations, and for investigating, documenting, and assessing reports of misconduct.

Commercial-item contractors and small businesses that find themselves under the gun will be in a significantly better position if they can point to robust internal controls consistent with the requirements of FAR 52.203-13.

Like it or not, mandatory disclosure and certain mandatory minimum internal controls are now part of the price of doing business with the federal government. Commercial-item contractors and small businesses would be wise to pay close attention to the requirements of the new rule and to ensure that their existing systems are sufficient.

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