

AKIN GUMP
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Contractor Code Of Business Ethics And Conduct And Mandatory Disclosure Rule

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Summary of Rule (73 Fed. Reg. 67064 (Nov. 12, 2008))

- New Contract Clause
(FAR 52.203-13) (Dec. 2008)
- New Cause for Suspension/Debarment
(FAR 9.406-2(b)(1)(vi) and 9.407-2(a)(8))
- New Definition of Principal
(FAR 2.101, 52.203-13, and 52.209-5)
- New Responsibility and Past Performance
Information Standards
(FAR 9.104-1 and 42.1501)

New Contract Clause (FAR 52.203-13) (Dec. 2008)

- This clause must be included in **all** contracts greater than \$5M with a period of performance longer than 120 days
- Contractors and subcontractors who have the clause must flow it down to all subcontractors with subcontracts greater than \$5M and a period of performance longer than 120 days
- Flowdown obligation includes small businesses, commercial item subcontractors and foreign subcontractors

New Contract Clause (FAR 52.203-13) (cont'd)

- FAR 52.203-13(b) requires **all** contractors or subcontractors with the clause, **including commercial item contractors and small businesses**, to:
 - ◆ Have a “written code of business ethics and conduct” that is made available to each employee engaged in performance of the contract
 - ◆ Exercise due diligence to prevent and detect criminal conduct
 - ◆ Otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law
 - ◆ Timely disclose to agency IG whenever, in connection with the award, performance, or closeout of the contract containing the clause, the contractor has “credible evidence” of certain criminal violations or violations of the civil False Claims Act by any employee, principal, agent, or subcontractor

New Contract Clause (FAR 52.203-13) (cont'd)

- FAR 52.203-13(c) requires contractors and subcontractors with the clause **other than commercial item contractors and small businesses** to implement:
 - ◆ an ongoing business ethics and awareness program; and
 - ◆ an internal control system

New Contract Clause (FAR 52.203-13) (cont'd)

Ongoing Business Ethics and Awareness Program

- The Clause requires ongoing business ethics awareness program and compliance program to:
 - ◆ Include reasonable steps 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
 - ◆ Provide the training under the program to the Contractor's principals and employees, and, as appropriate, the Contractor's agents and subcontractors

New Contract Clause (FAR 52.203-13) (cont'd)

Internal Control System

- The internal control system required by the Clause must:
 - ◆ Establish standards/procedures to timely discover improper conduct in performance of Gov't contracts
 - ◆ Ensure corrective action is carried out
 - ◆ Assign resources and responsibility at high enough level to ensure effectiveness of program
 - ◆ Include reasonable efforts not to employ individuals as principals who have engaged in conduct that conflicts with code of conduct

New Contract Clause (FAR 52.203-13) (cont'd)

- Internal control system must (cont'd):
 - ◆ Require periodic review of policies and practices for compliance with code of conduct, including periodic
 - Monitoring to detect unlawful conduct
 - Evaluation of effectiveness of internal control system
 - Assessment of risk of criminal conduct with appropriate risk avoidance steps
 - ◆ Include internal reporting mechanism (e.g., ethics hot line) that is confidential
 - ◆ Provide for disciplinary action for violations or failure to take reasonable steps to prevent/detect improper conduct

New Contract Clause (FAR 52.203-13) (cont'd)

- Internal control system must (cont'd):
 - ◆ Ensure timely disclosure to agency IGs whenever, in connection with the award, performance, or closeout of **any** of the contractor's or subcontractor's Government contracts, the contractor or subcontractor has credible evidence that a principal, employee, agent, or subcontractor:
 - Has committed a violation of 18 U.S.C. involving:
 - ▶ fraud
 - ▶ conflict of interest
 - ▶ bribery
 - ▶ gratuities, or
 - Has committed a violation of the civil False Claims Act (31 U.S.C. §§ 3729-3733)
 - ◆ Provide for "full cooperation with any Government agencies responsible for audits, investigations, or corrective actions."

New Cause for Suspension or Debarment

- A contractor may be suspended or debarred for the “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 –
 - ◆ Violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code;
 - ◆ Violation of the civil False Claims Act (31 U.S.C. §§ 3729-3733); or
 - ◆ Significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments as defined in FAR 32.001.”

New Definition of “Principal” (FAR 2.101)

- “*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).”
- Preamble states that “this definition should be interpreted broadly, and could include compliance officers or directors of internal audit, as well as other positions of responsibility.”

“Credible Evidence”

- The FAR Councils initially proposed a “reasonable grounds to believe” standard for mandatory disclosure.
- Preamble states that 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.”
- “This does not impose upon the contractor an obligation to carry out a complex investigation, but only to take reasonable steps that the contractor considers sufficient to determine that the evidence is credible.”

“Credible Evidence” (cont’d)

- Black’s Law Dictionary defines “credible evidence” as “evidence that is worthy of belief; trustworthy evidence.”
- Black’s also defines “credible evidence” as “[s]uch evidence as is sufficient to produce a belief that the thing is true.”
- Caselaw uses similar language

“Credible Evidence” (cont’d)

- HHS OIG Guidance for Pharmaceutical Manufacturers states that “where the compliance officer, compliance committee, or a member of senior management discovers **credible evidence** of misconduct from any source and, after a reasonable inquiry, believes that the misconduct may violate criminal, civil, or administrative law, the company should promptly report the existence of misconduct to the appropriate federal and state authorities within a reasonable period, but not more than 60 days, after determining that there is credible evidence of a violation.” 68 Fed. Reg. at 23742 (May 5, 2003) (emphasis added).

“Credible Evidence” (cont’d)

- **OIG Guidance:** “Credible evidence” is what prompts a reasonable inquiry
- **FAR Rule:** “Credible evidence” is what results from a reasonable inquiry
- **Logical Inference:** “Credible evidence” includes all facts and circumstances developed in the reasonable inquiry, not just the information that gave rise to the inquiry.

“Timely Disclosure”

- For purposes of the clause, timeliness is measured from the later of:
 - ◆ The date a contractor determines that there is credible evidence of a violation;
 - ◆ The date the contract clause was incorporated; or
 - ◆ The date that the contractor's internal control system was established

“Timely Disclosure”

Look Back Requirement

- “Timely disclosure” for purposes of the clause and the new cause for suspension and debarment requires all contractors and subcontractors (regardless of whether they have the new clause in any contract) to “look back” to all contracts or subcontracts on which final payment had not been made for more than three years as of December 12, 2008
- This look-back requirement is not limited to the knowledge of “principals” unless the contractor does not have the clause in any contract or subcontract

“Significant Overpayment”

- Not defined
- Does not include contract financing payments under FAR 32.001 (e.g., payments before final acceptance of goods/services)
- Preamble states: “This rule is aimed at the type of overpayment that the contractor knows will result in unjust enrichment, and yet fails to disclose it.”
- Beware potential overlap with “reverse false claims” [See next slide]

2009 FCA Amendments

Reverse False Claims

- Broadened Scope of Liability for Reverse False Claims
 - ◆ Reverse false claim provision expanded to reach one who “knowingly conceals or knowingly and improperly avoids or decreases” an obligation to pay or transmit money or property to the Government
 - No false statement or record needed for liability
 - “Improper” unclear
 - ◆ New unclear definition of “obligation”:
 - “Established duty, whether or not fixed, arising from an express or implied contractual, grantor-grantee, or licensor-licensee relationship, from a fee-based or similar relationship, from statute or regulation, **or from the retention of any overpayment**” (emphasis added)

“Full Cooperation”

- “Full cooperation” must be given to all Government agencies responsible for audits, investigations or corrective actions
 - ◆ Full cooperation is defined as “disclosure to the Government of the information sufficient for law enforcement to identify the nature and extent of the offense 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.*” FAR 52.203-13(a) (emphasis added).
 - ◆ Preamble states that: “compliant contractors will encourage employees to both make themselves available and to cooperate with the Government investigation.”

“Full Cooperation” (cont'd)

- “Full cooperation” does **not** require:
 - ◆ A contractor to waive its attorney-client privilege or attorney work product protections
 - ◆ An officer, director, owner, or employee of contractor to waive his/her attorney client privilege or Fifth Amendment rights
 - ◆ A contractor to refrain from conducting an internal investigation or defending a proceeding or dispute arising under the contract or related to a potential or disclosed violation

“Full Cooperation” (cont'd)

- **FAQ:** Will my company be penalized for an employee’s decision not to speak to the Government?
 - ◆ **Draft ABA Task Force Answer:** No. Unless you actually *discourage* your employees from cooperating with the Government, either explicitly or implicitly, you will not be penalized for an employee’s independent decision not to cooperate. The commentary to the new rule makes clear that cooperation is measured by the actions of the company itself, not by the actions of the individuals within the company. Employees may have reasonable and lawful reasons to avoid speaking to the Government. You must not, however, in any way discourage your employees from speaking to the Government. Discouraging your employees from speaking to the Government — even with a “wink and a nod” — may be viewed by the Government as a lack of cooperation, or, in some circumstances, as obstruction of justice.

“Full Cooperation” (cont'd)

- **FAQ:** Do I have to discipline employees who refuse to talk to the Government?
 - ◆ **Draft ABA Task Force Answer:** No. It is up to your employees whether they want to talk to the Government, and it would not necessarily be misconduct to decline to speak to the Government. Moreover, the Rule makes clear that an employee’s decision not to speak to the Government will not be viewed as the company’s failure to cooperate.

“Full Cooperation” (cont'd)

- **FAQ:** Do I have to worry about running afoul of any labor/employment issues if I encourage my employees to speak to the Government?
 - ◆ **Draft ABA Task Force Answer:** Possibly. Since your labor/employment obligations will vary depending upon your state, it is wise to consult legal counsel or your Human Resources specialist in this regard.

Internal Control Systems and the DCAA

- Some DCAA auditors have taken very aggressive positions in reviewing contractor internal control systems.
- DCAA auditors have sought to “verify” that system provides disclosure to **DCAA** and the ACO of all findings that significantly impact government contracts **within 5-10 days of identification.**
- DCAA auditors have requested a list of violations of the code of conduct/ethics as well as all hotline and other reports of misconduct that occurred in prior 12 months.
- DCAA auditors have requested copies of all internal policies and procedures for timely reporting as well as documents relating to “management overrides.”

DCAA Policy Guidance

- DCAA Headquarters recently issued audit guidance that addresses verification of contractor internal control systems and new mandatory disclosure rules. (DCAA Audit Guidance Mem. 09-PAS-014(R) (July 23, 2009).
- This guidance is much less specific and sweeping than some earlier DCAA requests.
- Guidance:
 - ◆ “Request a copy of any disclosures made and verify that the contractor complied with their policies and procedures.”
 - ◆ “Auditors should ensure that the contractor’s policies and procedures include a reasonable definition of credible evidence, and a reasonable timeframe for disclosure once credible evidence is obtained.”

DCAA Policy Guidance

- Guidance (cont'd):
 - ◆ “Contractors are allowed to take time for preliminary examination of the evidence to determine its credibility prior to disclosure.”
 - ◆ “Once the contractor has had sufficient time to take reasonable steps to determine that the evidence is credible, the contractor should disclose the violation in a timely manner.”
 - ◆ “Auditors should verify that the contractor did not delay disclosing the violation once it was determined that credible evidence exists.”
 - ◆ “If the auditor finds that the contractor failed to disclose the violation in a timely manner, an internal control deficiency should be reported.”
 - ◆ “Review any disclosures reported to the OIG and contracting officer and ascertain if the contractor has taken the necessary corrective actions to protect the Government’s interests.”
 - ◆ “If the contractor has not taken the appropriate corrective action, the auditor should report this as an internal control deficiency.”

Significant Issues That The Task Force Guide Will Address

- How to Obtain Information Regarding Reportable Conduct From Principals and Employees
- Subcontractors
- Proprietary Information – FOIA
- Privilege
- Warnings to Employees
- Application of Mandatory Disclosure Requirement to Grants Funded with Recovery Act Money

Significant Issues That The Task Force Guide Will Address (cont'd)

- What does “credible evidence” mean? What is the relationship of “credible evidence” to preponderance of the evidence? Adequate evidence?
- What kind of conduct is covered by the rule?
- Is any conduct that is too insignificant to be required to be disclosed? In other words, is there a *de minimis* threshold for mandatory reporting?
- How does a large company find out what its employees and agents know or suspect about potential criminal or civil FCA violations or potential significant overpayments?

Significant Issues That The Task Force Guide Will Address (cont'd)

- How can a company reasonably determine who its “principals” are? Does “primary” modify the term “supervisory responsibility?” If so, what is “primary supervisory responsibility”?
- Is every supplier a “subcontractor” for purposes of the MDR? How can a contractor verify that its subcontractors have an adequate code of business ethics and/or internal compliance program? How can a contractor determine whether there is credible evidence that a subcontractor has committed a covered criminal or civil FCA violation or has received a significant overpayment?

Significant Issues That The Task Force Guide Will Address (cont'd)

- What is the difference between receipt of a significant overpayment and a “reverse false claim” based upon such a payment? When do you report a significant overpayment to the CO and when to the IG?
- Do voluntary disclosures still have a role under the MDR? If so, under what circumstances are voluntary disclosures appropriate? Are there benefits to making a voluntary disclosure rather than a mandatory disclosure? Risks?
- How can contractors best protect their disclosures from public release under FOIA? Release to Congress? Release to potential and actual *qui tam* relators?

Significant Issues That The Task Force Guide Will Address (cont'd)

- What effect will mandatory disclosures have on responsibility determinations by COs? Past performance evaluations? Competitions? Bid protests?
- What is a company's financial reporting requirements regarding mandatory disclosures? Voluntary disclosures?
- What kind of internal control systems will prove effective? Will small business and commercial contractors be required as a practical matter to adopt internal control systems to comply with their mandatory disclosure requirements?

Questions?

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