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FINAL RULE BRINGS SIGNIFICANT CHANGE TO THE FEDERAL ACQUISITION REGULATION'S DISCLOSURE, ETHICS, AND INTERNAL CONTROL REQUIREMENTS

On December 12, 2008, the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (the "Councils") issued a final rule that significantly expands the obligations of government contractors with regard to the disclosure of procurement law violations and the implementation of codes of business ethics and internal control systems. The final rule also creates new grounds for contractor suspension and/or debarment. The Councils' stated intent in promulgating the rule was to "emphasize the critical importance of integrity in contracting and reduce the occurrence of improper or criminal conduct in connection with the award and performance of Federal contracts and subcontracts."[1]

NEW DISCLOSURE REQUIREMENTS FOR GOVERNMENT CONTRACTORS

Under the new rule, all government contracts expected to exceed $5 million with a performance period of at least 120 days must incorporate expanded disclosure requirements. These new requirements mandate that the contractor "timely disclose," in writing, to the relevant agency's Office of the Inspector General ("OIG") and the relevant contracting officer, any instances of "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; or
- A violation of the civil False Claims Act.[2]

The "credible evidence" standard replaces the "reasonable grounds to believe" standard that was part of the proposed rule, consistent with the recommendation of the Department of Justice's Criminal Division. Although the rule does not define "credible evidence," the Councils noted that the term should "indicate[] 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."[3]

The Councils further suggested that the "credible evidence" standard should aid contractors in understanding the term "timely disclose," which is also left undefined by the rule. The Councils rejected the inclusion of a rigid time period for the disclosure requirement, in part because 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."[4] Finally, in response to comments from the Department of Justice and agency OIGs,[5] the final rule removed exemptions for commercial item contracts and contracts performed entirely outside the United States that had been included in the proposed rule.

DOD AND GSA DISCLOSURE FORMS

In response to the new rule, some agencies—including the Department of Defense and General Services Administration—have already issued standard forms for the reporting of violations addressed in the rule. These forms include requirements that contractors certify or attest to the truthfulness and accuracy of the report's contents. Industry organizations have challenged the inclusion of any such certification or attestation requirement as exceeding the mandate of the statute and rule and imposing unauthorized risks on contractors beyond the substantial risks posed by the rule itself. Industry groups have likewise taken issue with the electronic submission requirement apparently imposed by the GSA, noting that such a requirement without the review and approval of the Office of Information and Regulatory Affairs and without further information regarding site security protocols is both unwarranted and risks the unauthorized release of sensitive information. These issues are likely the first of many that will need to be addressed as agencies and contractors work through implementation of this significant rule change.

NEW GROUNDS FOR SUSPENSION OR DEBARMENT FURTHER EXPAND DISCLOSURE REQUIREMENTS

The new rule also amends FAR Part 9, Contractor Qualifications, by creating new grounds for the suspension and/or debarment of government contractors. Unlike the new disclosure requirements discussed above, which are limited to contracts exceeding $5 million and 120 days, the new grounds for suspension or debarment provided by the final rule apply to *all* contracts.[6] Under the changes to FAR Part 9, a contractor may face suspension or debarment for the knowing failure by a "principal" to "timely disclose" "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;
- A violation of the civil False Claims Act; or
- A significant overpayment on the contract.[7]

The terms "credible evidence" and "timely disclose" remain undefined, as does the term "significant overpayments." However, the Councils noted that the term "significant overpayments" "implies more than just dollar value and depends on the circumstances of the overpayment as well as the amount."[8]

The Councils included the term "principal" in response to comments suggesting that the "[f]ailure to disclose crime should not be a basis for suspension or debarment if lower-level employees, who are not managers or supervisors, commit a crime and conceal the crime from the contractor's supervisory-level personnel."[9] However, although the rule defines "principal" as "an officer, director, owner, partner, or a person having primary management or supervisory responsibilities within a business entity,"[10] the Councils noted that "this definition should be interpreted broadly, and could include compliance officers or directors of internal audit, as well as other positions of responsibility."[11] The Councils also explained that the term "knowing failure" signifies that "principals are only required to disclose what they know" and that the Councils' statements regarding the term "credible evidence" should inform the requirements for finding a "knowing failure."[12]

Notably, the disclosure necessary to avoid suspension and/or debarment is required even for contracts entered into prior to the effective date of this new rule. Contractors are required to disclose violations or overpayments on contracts that are either still open or for which there has been final payment within the last three years.[13] Failure to disclose these past violations or overpayments may lead to suspension or debarment.

CODES OF BUSINESS ETHICS AND INTERNAL CONTROL SYSTEMS

Lastly, the new rule expands existing regulations regarding ethics awareness and the development of compliance programs and internal control systems.[14] Small businesses and commercial item contractors *are* exempt from these requirements. For nonexempt contractors who meet the $5 million/120-day thresholds, the new regulations provide specific guidance for how to comply with the existing requirement to establish an "ongoing business ethics and business conduct awareness program."[15] In addition, the new rule provides further detail regarding existing "internal control system" requirements. Of note, one of the new minimum requirements for a compliant control system is that the contractor provide "full cooperation with any Government agencies responsible for audits."[16] The rule defines "full cooperation" 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."[17] In response to concerns regarding the impact of such a "full cooperation" requirement on the attorney-client privilege and Fifth Amendment rights, the rule expressly provides that "full cooperation" does *not* "foreclose any Contractor rights arising in law, the FAR, or the terms of the contract."[18]

These internal control system requirements are particularly important in light of DCAA audit guidance issued on December 19, 2008, that eliminated the practice of finding internal control systems "inadequate in part." The guidance specifically instructs government auditors who find any "significant deficiency" or "material weakness" in a system to find that system "inadequate," recommend to relevant contracting officers that the system be disapproved, and seek appropriate suspension of progress payments and/or reimbursement of costs.[19]

A "SEA CHANGE"

As the Councils themselves have acknowledged, these new mandatory disclosure requirements are a "sea change" and "major departure" from the voluntary disclosure scheme under which government contractors have long operated. All companies doing business with the federal government should be familiar with these new requirements and should update their existing compliance programs accordingly. Jones Day continues to help companies navigate the changing waters of federal procurement law, implement effective compliance programs, and resolve problems that may arise in all aspects of the government contracting process.

LAWYER CONTACTS

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ENDNOTES

1. 73 Fed. Reg. 67064, 67088 (Nov. 12, 2008).
2. FAR 52.203-13(b)(3(i).
3. 73 Fed. Reg. at 67073.
4. *Id.* at 67074.
5. *Id.* at 67083.
6. FAR 3.1003(a)(2) has been updated to specifically note that the suspension/debarment grounds apply "whether or not the clause at 52.203-13 is applicable."
7. FAR 9.406-2(b)(1)(vi).
8. 73 Fed. Reg. at 67080.
9. *Id.* at 67079.
10. FAR 2.101(b)(2); FAR 52.203-13(a).
11. 73 Fed. Reg. at 67079.
12. *Id.*
13. FAR 9.406-2(b)(1)(vi).
14. FAR 52.203-13(c).
15. FAR 52.203-13(c)(1).
16. FAR 52.203-13(c)(2)(ii)(G).
17. FAR 52.203-13(a)
18. *Id.*
19. DCAA Memorandum re "Audit Guidance on Significant Deficiencies/Material Weaknesses and Audit Opinions on Internal Control Systems" (Dec. 19, 2008).