

Global Regulatory Enforcement

If you have questions or would like additional information on the material covered in this Alert, please contact one of the authors:

Lorraine M. Campos
Partner, Washington, D.C.
+1 202 414 9386
lcampos@reedsmith.com

Gregory S. Jacobs
Associate, Washington, D.C.
+1 202 414 9480
gjacobs@reedsmith.com

Brett D. Gerson
Associate, Washington, D.C.
+1 202 414 9440
bgerson@reedsmith.com

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FAR Mandatory Disclosure Rule

On November 12, 2008, the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council issued an amendment to the Federal Acquisition Regulation ("FAR") to establish: (1) mandatory disclosure requirements for certain violations of federal criminal law and the False Claims Act; (2) requirements for contractors to establish and maintain specific internal controls to detect, prevent, and disclose improper conduct in connection with the award or performance of any government contract or subcontract; and (3) new causes for suspension and debarment. See 73 Fed. Reg. 219, 67,064 (Nov. 12, 2008). The final rule went into effect December 12, 2008, and applies to all federal government contracts in amounts greater than \$5 million and more than 120 days in duration, including small business and commercial item contracts. Certain exceptions are discussed below.

Mandatory Disclosure of Misconduct

Government contractors are now *required* to timely disclose to the contracting agency's Office of Inspector General (providing a copy to the contracting officer) whenever, in connection with the award, performance, or closeout of a government contract, the contractor has "credible evidence" that a principal, employee, agent, or subcontractor has committed a violation of federal criminal law involving fraud, conflict of interest, bribery, or improper gratuity violations found in Title 18 of the U.S. Code, or a violation of the civil False Claims Act (31 U.S.C. 3729–3733). This disclosure requirement applies until three years after final payment on the contract.

The term "credible evidence" is not defined in the rule, but it is a higher standard than the "reasonable grounds to believe" standard included in the proposed regulations. This change 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 FR 67063. Many contractors are likely to conclude that it is not clear how the credible evidence standard will be applied, and err on the side of caution: when in doubt, disclose.

The final rule also revises FAR 52.203-13(b), Contractor Code of Business Ethics and Conduct, and requires contractors to have a written code of business ethics and develop reliable internal procedures to detect, process, investigate and assess potential violations to determine whether there is credible evidence triggering a reporting obligation.

Establishment of Internal Control Systems

The revised FAR 52.203-13(c) also requires contractors to establish, within 90 days of contract award, a "business ethics awareness and compliance program and internal control system," which must include effective training. A contractor's internal control system must provide for compliance with the mandatory disclosure requirements discussed above. Contractors are required to flow down the substance of the clause to subcontracts exceeding \$5 million and 120 days, including commercial item subcontracts. The compliance program and internal systems requirements do not apply to small businesses or commercial item contracts.

New Causes for Suspension and Debarment

The final rule expands the causes for debarment or suspension to include the knowing failure by a principal, within three years after final payment on any government contract, to timely disclose to the government credible evidence of: (1) a violation of federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the U.S. Code; (2) a violation of the False Claims Act; or (3) significant overpayment(s) on the contract. The term "principal" is defined as "officers; directors; owners; partners; and, persons 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 compliance officers or directors of internal compliance programs. FAR 52.209-5; FAR 2.101.

Although the term “timely” is not defined in the final rule, it is noted that contractors “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 FR 67074. Thus, timely disclosure will be measured from the time that a principal concludes that evidence of wrongdoing is credible. The term “significant overpayment” is also not defined, but it is noted that it “implies more than just dollar value and depends on the circumstances of the overpayment as well as the amount...it is within the discretion of the suspension and debarment official to determine whether an overpayment is significant and whether suspension and debarment would be the appropriate outcome for failure to report such overpayment.” 73 FR 67080. Therefore, whether a principal has failed to disclose a significant overpayment will be determined on a case-by-case basis.

Nuances in Application

As mentioned above, the final rule applies to contracts and subcontracts exceeding \$5 million and 120 days, but with some nuance: (1) there is no requirement for the contractor to review or approve its subcontractors’ ethics code or internal control systems; (2) a prime contractor is subject to debarment if it fails to disclose known violations by its subcontractor; (3) the final rule allows subcontractors to disclose directly to the government, without requiring disclosure through the prime contractor; and (4) for small businesses, the formal training and internal control systems requirements are inapplicable, and the disclosure requirement is limited to known violations of federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the U.S. Code, and violations of the False Claims Act. Finally, it is important for contractors to note that the final rule is retroactive and applies to all contracts, including those entered into before the final rule went into effect and until three years after final payment, even if those violations occurred prior to the effective date of the rule and FAR 52.203-13 is not included in the contract.

Conclusion

The final rule presents many dilemmas for contractors. For example, some fear that the requirement that principals disclose all known violations may create an incentive within contracting companies to quarantine executives and top executives from their compliance programs and internal control systems. In addition, it will no doubt prove difficult for principals to decide in a short time-frame whether criminal conduct or a mere mistake has occurred in a given instance. The final rule does not answer these concerns, but its adoption should convey to contractors that the government is placing an increasing emphasis on compliance, and it has shifted significant self-oversight responsibility to contractors.

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