



NEW FEDERAL REGULATIONS REQUIRE CONTRACTORS TO “SELF DISCLOSE” VIOLATIONS OF FEDERAL CRIMINAL LAWS, VIOLATIONS OF THE CIVIL FALSE CLAIMS ACT, AND OVERPAYMENTS ON CONTRACTS

In our December 2007 Client Alert, “Federal Regulations Now Require *All* Government Contractors to Have a Comprehensive Compliance Program; Plus, Newly Proposed Regulations Would Further Expand Compliance Requirements,” we advised you of proposed regulations that, among other things, would impose on Government contractors a mandatory requirement to disclose suspected violations of federal criminal law in connection with the award or performance of Government contracts and subcontracts. As a result of final regulations issued by the Government on November 12, 2008, those regulations have now become a challenging and potentially troubling reality for all prime contractors and first tier subcontractors that have a contract exceeding \$5 million and a performance period of at least 120 days. Even the Government acknowledges that “[t]here is *no doubt that mandatory disclosure is a ‘sea change’ and ‘major departure’ from voluntary disclosure.*”

The Government’s latest ethics regulations amend the Federal Acquisition Regulation (“FAR”) to expand federal ethics and compliance requirements. The final regulations clarify the requirements for a contractor code of business ethics and conduct and an internal control system that were established in the previously adopted FAR regulations. More importantly, contractors will now be required to disclose to the agency’s Office of Inspector General (“OIG”) and Contracting Officer violations of the *criminal* provisions of federal ethics laws, as well as violations of the *civil* False Claims Act and any “significant overpayments” on contracts with the federal Government. Disclosures must be made whenever a contractor has “credible evidence” of a violation. Failure to disclose violations could result in suspension and/or debarment from doing business with the federal Government.

Adoption of the self disclosure requirement was understandably supported by the Inspectors General of the federal agencies and by the U.S. Department of Justice. In siding with these agencies, the drafters of the FAR regulations brushed aside serious concerns expressed by the business and legal communities regarding the need for and scope of the self disclosure requirement, its impact on employer/employee relations, potential jeopardy to Fifth Amendment rights, the attorney client privilege and attorney work product, and other concerns. *The final regulations take effect on December 12, 2008.* Below is a discussion of the key elements of the regulations.

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Mandatory Self Disclosure

In a major departure from the current *voluntary* disclosure regime, the final regulations contain *mandatory* self disclosure requirements. The new regulations were authorized by the “Close the Contractor Fraud Loophole Act,” which was enacted on June 30, 2008 as part of the Supplemental Appropriations Act of 2008 (Pub. L. 110-252). The Act required the FAR to be amended to require contractors to timely notify the Government of violations of federal criminal laws or overpayments in connection with the award or performance of covered Government contracts or subcontracts, including contracts performed outside the United States and contracts for commercial items.

Under the new regulations, the self disclosure requirement applies to contracts in an amount greater than \$5 million and more than 120 days in duration. Government contractors must “timely” disclose in writing to the agency OIG, with a copy to the Contracting Officer, whenever 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 of the United States Code¹; or
- A violation of the civil False Claims Act.

If the violation relates to more than one Government contract involving different agencies, the contractor may make the disclosure to the agency OIG and Contracting Officer responsible for the largest dollar value contract.

Credible Evidence. The self disclosure requirement applies when the contractor has “credible evidence” that a violation has occurred. This is a change from the originally proposed regulations, which would have required a contractor to self disclose when it had “reasonable grounds to believe” that a violation occurred. The change was made in response to industry concerns that the “reasonable grounds to believe” standard was subject to varying interpretations and could be viewed as a *lower* standard than probable cause. While the new “credible evidence” term is not defined in the final FAR regulations, the preface to the regulations states that the term indicates a *higher* standard than “reasonable grounds to believe.” Nevertheless, what constitutes “credible evidence” is obviously subject to widely divergent interpretations depending on the circumstances.

Civil False Claims Act. By the same token, contractors will be hard pressed to determine when there is credible evidence of a violation of the civil False Claims Act. The boundaries of the False Claims Act are undefined and constantly changing. Different federal courts have different interpretations of such basic concepts as whether the submission of a payment request when a contractor is not in full compliance with all of the terms and conditions of the contract can be, in and of itself, a violation of the Act.

¹ Title 18 of the U.S. Code includes most of the federal criminal laws that govern ethics, including the criminal provisions of the False Claims Act, False Statements Act, Mail and Wire Fraud statutes, Bribery and Gratuities statutes, Ethics Reform Act and Major Fraud Act. The final regulations do not specifically address the Anti-Kickback Act (“AKA”). The AKA may have been omitted because the Act already contains a self disclosure requirement.



For this reason, the new regulations recognize that genuine disputes over the application of the False Claims Act may be considered by the Government in evaluating whether a contractor knowingly failed to disclose a violation. The mere filing of a whistleblower (“*qui tam*”) action or a Government decision to intervene in a whistleblower case would not, standing alone, constitute credible evidence of a violation that must be reported. Nevertheless, these qualifications provide little comfort to a contractor that must make a difficult disclosure decision and risk being second guessed later by the Government for having made the wrong decision.

In this regard, industry had expressed the concern that mandatory disclosure of violations of the civil False Claims Act would create a risk that whistleblowers would then bring *qui tam* law suits against the disclosing contractor based on the disclosure. In response to this concern, the FAR drafters simply stated that this is a risk that contractors will have to take and that timely disclosure will have the benefit of possibly avoiding suspension or debarment and possibly obtaining a reduction in the False Claims Act penalties that would otherwise be imposed.

Timely Disclosure. Although the regulations require contractors to “timely” disclose violations, the FAR drafters indicated that a contractor will have a reasonable period of time to conduct a preliminary examination of the evidence to determine its credibility before deciding to disclose to the Government. Unless and until a contractor reasonably determines that the evidence is credible, it is not required to make a disclosure to the Government.

Full Cooperation. The requirement for full cooperation with Government agencies responsible for audits, investigations, or corrective actions obligates contractors to disclose to the Government information sufficient for law enforcement to identify the nature and extent of the offense and the individuals responsible for the conduct. It includes timely and complete responses to Government auditors’ and investigators’ requests for documents and access to employees with information. Cooperation is measured by the cooperation of the contractor itself and not the cooperation of individuals within the contractor’s organization. This means that a contractor should not be penalized if its employees invoke their Fifth Amendment rights. A contractor may still be given full credit for cooperation if, because of the lack of cooperation of particular individuals, neither the contractor nor law enforcement personnel are able to identify the culpable individuals responsible for the violation.

OIG Involvement in Contracts. One of the obvious questions raised by the new FAR regulations is whether they will mean that agency Inspectors General will be constantly looking over contractors’ shoulders hoping to find violations that have not been disclosed. The drafters of the regulations attempt to allay this concern by stating that OIG agents will not be “routinely involved” in company internal ethics functions and contract administration “unless violations are disclosed.”



Impact on Labor Agreements. In response to concerns that the new regulations might violate existing labor agreements with unions if the self disclosure requirements are imposed without bargaining, the FAR drafters cavalierly stated that “contractors can find ways to disclose without violating labor union provisions that protect individual privacy of workers.”

Attorney Client Privilege and Attorney Work Product. The FAR final regulations provide that the self disclosure requirement does not require a contractor to waive its attorney-client privilege or the protections afforded by the attorney work product doctrine. This limitation, however, cannot be used to excuse the failure to self disclose *facts* (as opposed to impressions and opinions), which would not be subject to protection. In addition, the regulations provide that the self disclosure requirement does not require any officer, director, owner, or employee of the contractor, including a sole proprietor, to waive his/her attorney client privilege or Constitutional right against self-incrimination under the Fifth Amendment. Although the regulations do not *require* a Fifth Amendment waiver (no regulation could) and do not *require* a contractor’s counsel to Mirandize employees before interviewing them in an investigation, counsel may nevertheless conclude that they are ethically obligated to warn employees. This, in turn, could have a chilling effect on a contractor’s ability to conduct an effective internal investigation, not to mention employer/employee relationships.

Protection of confidential information. If a contractor’s disclosure is marked “confidential” or “proprietary,” it will be safeguarded by the Government and treated as confidential. The information will be withheld under the Freedom of Information Act (“FOIA”) to the extent permitted by FOIA and will not be released without prior notification. Thus, *it is crucial that any disclosures be appropriately marked.*

Suspension/Debarment

Under the final regulations, a contractor may be suspended and/or debarred if a principal of the contractor knowingly fails to timely disclose credible evidence of a violation of Federal criminal law involving fraud, conflict of interest, bribery or gratuity violations or a violation of the civil False Claims Act in connection with the award, performance, or closeout of a Government contract performed by the contractor or a subcontract awarded under a Government contract. In addition, a contractor may be suspended and/or debarred if a principal of the contractor knowingly fails to disclose credible evidence of a significant Government overpayment, other than an overpayment resulting from contract financing payments.

Significant Overpayment. The final regulations provide no clear guidance as to what constitutes a “significant” overpayment. However, the drafters do state that this determination depends on both the dollar value and “the circumstances of the overpayment.” The drafters noted that standard Payment clauses already require contractors to disclose and return overpayments of any amount.



Involvement of Principal. Under the final regulations, the term “principal” is defined to include an officer, director, owner, partner, or a person having primary management or supervisory responsibilities such as a general manager, plant manager, head of a subsidiary, division, or business segment, or similar position. This definition will be interpreted broadly and could include *compliance officers or directors of internal audits*, as well as other positions of authority.

Relevant Time Period. The knowing failure to timely disclose remains a cause for suspension and/or debarment *for three years after final payment on a contract*. As a result, even though the self disclosure requirement applies only to covered contracts awarded after December 12, 2008 (the effective date of the final regulations), a contractor’s failure to disclose a violation that occurred *prior* to December 12, 2008 may subject the contractor to suspension and/or debarment if the violation falls within the three year reporting period. The three year reporting period is measured from the date of the contractor’s determination that the evidence is credible or the effective date of the regulations, whichever occurred later. If violations under an *ongoing* contract took place before December 12, 2008, then those violations must be disclosed or the contractor will risk suspension and/or debarment if the violations are subsequently discovered by the Government.

Code of Business Ethics and Conduct and Internal Control System

Code of Conduct. The requirement to have a written code of business ethics and conduct and an internal control system is clarified under the final regulations. The contractor must provide a copy of the code to each employee engaged in performance of the contract. The manner of communicating the code is left up to each contractor. A contractor may have different codes of conduct that apply to different segments of a contractor’s business lines. The FAR drafters also pointed out that the internal controls required by the earlier compliance regulations (See P&A’s “Federal Regulations Now Require *All* Government Contractors to Have a Comprehensive Compliance Program; Plus, Newly Proposed Regulations Would Further Expand Compliance Requirements,” December 2007), reflect the Government’s “minimum expectations” and that contractors are free to establish more rigorous ethical standards.

Bottom Line

With the FAR’s imposition of new mandatory self disclosure requirements, Government contractors have effectively become “partners” with the Inspectors Generals of the agencies with which they have contracts. Although the Government’s commitment to eradicate procurement fraud is laudable, the legal, financial, and practical consequences of the policies intended to accomplish this public policy will have a profound impact on all government contractors.



Client Alert

Today, more than ever, it is critically important that Government contractors institute and implement an effective compliance program. The Corporate Ethics and Compliance Practice Group of Peckar & Abramson has been actively counseling existing and new clients on implementing effective compliance programs that satisfy the Government's ethics and compliance requirements. The Corporate Ethics and Compliance Practice Group is poised to assist Government contractors in determining whether a self disclosure is necessary and how to make it. We also have extensive experience conducting internal investigations of potential violations of the entire range of federal criminal and civil ethics laws.