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#### **New Mandatory Disclosure and Compliance Requirements Will Impact All Government Contractors**

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On November 12, 2008, the federal government published a new rule that significantly affects the compliance obligations of all companies doing business with the federal government. The new rule expands the scope of contractors who are required to have a code of business ethics and conduct and an internal control system. The rule also mandates, *inter alia*, disclosure to the government of certain violations of criminal law, violations of the civil False Claims Act, and significant overpayments. The new rule is effective December 12, 2008.

#### **Code of Business Ethics and Conduct**

The new rule builds upon amendments to the Federal Acquisition Regulation (“FAR”) that went into effect late last year. As discussed in a prior legal update (“[Proposal Would Make Business Ethics Rules Mandatory for Companies](#)”), December 2007 amendments to the FAR required all contractors receiving awards expected to exceed \$5 million and with performance periods of 120 days or more (“Covered Contracts”) to have a written ethics code and an internal control system.<sup>[1]</sup> This requirement did not apply to commercial item acquisitions or contracts performed entirely outside the United States. Moreover, while small businesses were required to have a written ethics code, they were exempt from the requirement for a formal ethics awareness program and internal control system.

In response to public comments on the new rule and the Close the Contractor Fraud Loophole Act <sup>[2]</sup>, enacted on June 30, 2008, the new rule eliminates the previous exemption from the ethics compliance requirements for commercial item acquisitions and contracts performed entirely outside the United States. As a result, all contractors receiving Covered Contracts are now subject to FAR 52.203-13, Contractor Code of Business Ethics and Conduct, which implements the new requirements. The new rule continues to exempt small businesses from the requirement for a formal ethics awareness program and internal control system. Commercial item acquisitions are likewise exempt from the requirement for a formal ethics awareness program and internal control system. The requirements in FAR 52.203-13 must flow down to subcontractors who have Covered Contracts.

Under the new rule, a contractor’s internal control system must provide, at a minimum, for the following: assignment of responsibility at a sufficiently high level in the organization and the commitment of adequate resources; reasonable efforts not to include an individual as a principal who is known to have engaged in conduct contrary to the contractor’s code of business ethics and conduct; periodic reviews of business practices, procedures, policies and internal controls; internal reporting mechanism; disciplinary action for improper conduct; timely disclosure of wrongdoing; and full cooperation with government investigators and auditors. For contractors who do not already have such internal controls in place, implementing these new mandatory elements is likely to increase the cost of doing business with the government.

Many of the comments on the proposed rule expressed concerns regarding the meaning of “full cooperation” and whether the government would interpret the term to require waiver of privileges

and rights. In response, the FAR Council defined “full cooperation” in a way to make clear that it does not require waiver of the attorney-client privilege or protections under the attorney work product doctrine. Also, “full cooperation” does not require any officer, director, or employee to waive his or her Fifth Amendment rights, nor does it prevent the contractor from conducting an internal investigation, or from defending a dispute arising under the contract or related to a reported violation.

## Mandatory Disclosure

The most significant change introduced by the new rule relates to the disclosure requirements imposed on contractors. The rule requires a government contractor to make a timely disclosure to the agency Office of Inspector General, with a copy to the contracting officer, whenever, in connection with the award, performance, or closeout of a government contract or subcontract thereunder, the contractor has “credible evidence” of:

- a violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violation found in Title 18, United States Code;
- a violation of the civil False Claims Act; or
- significant overpayments on the contract.

The mandatory disclosure requirements became law with the enactment of the Close the Contractor Fraud Loophole Act in June 2008.<sup>[3]</sup> The new rule implements this statutory mandate in two ways. First, it adds mandatory disclosure requirements to FAR 52.203-13, which applies to Covered Contracts. Second, it amends FAR Subpart 9.4, which addresses suspension and debarment, by adding the knowing failure by a company “principal” to “timely” disclose a reportable violation or significant overpayment as a ground for suspension or debarment. Because FAR Subpart 9.4 applies to all contractors, not just Covered Contracts, the practical effect of this amendment is to extend mandatory disclosure requirements to all contractors.

In implementing the new rule, the FAR Council makes clear that, in all cases, reportable violations are linked to the award, performance or close-out of government contracts awarded to the contractor (or subcontractors thereunder).<sup>[4]</sup> That is, contractors are not obligated to report violations occurring in connection with another company’s government contracts. Moreover, the disclosure requirement for an individual contract continues after final payment for three years. Thus, a contractor is obligated under FAR 52.203-13 and/or FAR Subpart 9.4 to report a violation or significant overpayment whenever the contractor obtains credible evidence of the same during the term of the contract or within three years after final payment.

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The federal government’s renewed emphasis on procurement fraud should be a reminder to all contractors to make certain that their compliance programs are up to date and effective. While the majority of government contractors may believe their compliance programs are already adequate, it is prudent to review them in light of the new standards and mandatory disclosure requirements in this area. Also, new companies entering the federal marketplace should ensure that they understand the requirements accompanying the award of a federal contract.

[1] FAR 3.1004(a) (FAC 2005-22); FAR 52.203-13 (Dec 2007).

[2] Pub. L. 110-252, Title VI, Chapter 1.

[3] The Act specifically mandates the amendment of the FAR to include provisions that require timely notification of violations of Federal criminal law or overpayments in connection with the award or performance of Covered Contracts. The new rule goes beyond the Act by requiring disclosure of violations of the civil False Claims Act and by encompassing violations in connection with any government contract, not just Covered Contracts.

[4] The new rule actually establishes three mandatory disclosure requirements: a direct reporting requirement applicable to all Covered Contracts and encompassing violations in connection with those Covered Contracts (FAR 52.203-13(b)(3)); a reporting requirement under the formal internal control system applicable to all Covered Contracts other than those with small businesses and

commercial item acquisitions and encompassing violations in connection with *any* government contract (FAR 52.203-13(c)(2)(ii)(F)); and a reporting requirement under the debarment and suspension provisions applicable to *all* contractors and encompassing violations in connection with *any* government contract (FAR Subpart 9.4).