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Proposal Would Make Business Ethics Rules Mandatory for Companies

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The federal government has recently proposed a rule that, if it becomes final, will impose additional compliance obligations on most companies doing business with the federal government.

On November 14, 2007, the Civilian Agency Acquisition and Defense Acquisition Regulation Councils ("Councils") issued a proposed government-wide rule that would require federal contractors to notify contracting officers and agency inspectors general of suspected violations of criminal law committed in connection with the award or performance of federal contracts and to fully cooperate with federal investigators. Several of the Councils' proposed changes come at the request of the Department of Justice. The public comment period for the proposed rule will expire on January 14, 2008. The proposed rule builds upon recent amendments to the Federal Acquisition Regulation requiring contractors to have a written ethics code and internal control system.

Code of Ethics and Business Conduct

The November 14, 2007 proposed rule builds upon prior recent amendments to the FAR that will become effective on December 24, 2007.

The recent amendments to the FAR require all contractors receiving awards expected to exceed $5 million and with a performance period of 120 days or more (except for commercial item acquisitions or contracts performed entirely outside the United States) to have a written ethics code. It does so by including two new provisions, FAR 52.203-13 and 52.204-14, in solicitations and contracts, which flow down to subcontractors.

Among other things, a contractor subject to the new FAR clauses is required to disseminate its written code to employees; provide training; implement internal controls to facilitate timely discovery of improper conduct and ensure that corrective measures are promptly instituted; and display fraud hotline posters. FAR 52.203-13 further provides that a contractor's internal control system should include periodic reviews of the company's practices and procedures and the sufficiency of its internal controls; internal reporting mechanisms; and disciplinary actions for improper conduct. The requirements for a formal ethics awareness program and internal control system do not apply to small businesses.

The November 14, 2007 proposed rule would build on these recent amendments to the FAR in two ways. First, it would convert the elements that an internal control system "should" have into elements that an internal control system "must" have. Second, it would add additional mandatory elements, such as the assignment of responsibility at a sufficiently high level of the organization and the commitment of adequate resources to ensure effectiveness of the compliance program and internal control system.

Required Reporting

The latest proposed rule would also go beyond the one that becomes effective on December 24th by

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requiring a contractor to immediately notify the government when it has reasonable grounds to believe that a principal, employee, agent, or subcontractor violated federal criminal law in connection with the award or performance of a contract or subcontract. What constitutes "reasonable grounds" and how this proposed rule may affect voluntary disclosures programs will, no doubt, generate substantial public comment.

The proposed rule also amends FAR 9.406-2 and 9.407-2 to provide that the knowing failure to timely disclose a violation of federal criminal law in connection with a government contract is a ground for suspension and for debarment. This provision would apply to all contractors.

Full Cooperation

One of the proposed elements of the required compliance program is that the contractor provide "full cooperation" with any government agencies responsible for audit, investigation or corrective actions. The proposed rule does not, however, attempt to define what constitutes full cooperation. A primary question left unanswered is whether a company would be required to waive the attorney-client privilege in order to be deemed as having fully cooperated.

Waiver of the attorney-client privilege has been a controversial subject in recent years. The Department of Justice issued a series of memoranda entitled "Principles of Federal Prosecution of Business Entities" that directed prosecutors to consider a company's cooperation when deciding whether to bring criminal charges against a company. In gauging the extent of the company's cooperation, prosecutors were specifically told that they could consider the company's willingness to waive attorney-client privilege and work product protection. This aspect of the Justice Department's policy generated significant criticism and led to proposed legislation in Congress. Ultimately, the Department issued a "clarification" of its policy on waiver that represents a slight retrenchment. Please see McNulty Memorandum. Apparently recognizing that similar issues would result from its proposed requirement that contractors provide full cooperation, the Councils stated that this element of the proposed rule will not immediately be included in the final rule, in order to allow additional time for comment and analysis of the privilege waiver issue.

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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 developing standards and new requirements in this area. Also, new companies entering the federal marketplace should ensure that they understand the requirements that accompany the award of a federal contract.

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