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Mintz Levin Cohn Ferris Glovsky and Popeo PC

Federal Contractor Alert: The Coming "Sea Change" for Federal Contractors and Subcontractors

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Federal Acquisition Regulation to Impose Contractor Disclosure Obligation upon Credible Evidence of a Violation of Law or Contract

Effective **December 12, 2008**, contractors and subcontractors working on federal contracts will be required to disclose to the U.S. government credible evidence of fraud or misconduct in connection with the award, performance, or closeout of such federal contracts. Failure to disclose known violations of federal law involving the contract may result in suspension or debarment of the contractor or its principals from contracting with federal agencies.

A final rule amending the Federal Acquisition Regulation (FAR) was published on November 12, 2008. It amplifies last year's FAR requirement that contractors or subcontractors working on federal contracts valued at over $5 million or to be performed over more than 120 days create a written code of business ethics and institute compliance training programs.[1] Beginning December 12, 2008, contractors and subcontractors performing federal contracts—irrespective of monetary value or duration—will be legally obligated to disclose to the relevant federal agency's Office of Inspector General (OIG) **credible evidence** of

- federal criminal law violations involving fraud, conflict of interest, bribery or gratuities;
- violations of the civil False Claims Act; or
- significant overpayment on the contract.

Contractors who do not discover credible evidence of such wrongdoing until three years after final payment on the government contract, or later, are excused from the new disclosure rule.

This so-called "integrity reporting" rule also mandates that federal contractors and subcontractors establish and maintain specific internal controls to deter and detect improper conduct in connection with any government contract. These internal control systems must be established within 90 days after the contract award, unless the contracting officer establishes a longer time period.

The consequences for failing to comply with the amended FAR rules are drastic. Knowing failure by a contractor or its principals to make timely disclosure of violations in connection with the award, performance, or closeout of the contract or subcontract is cause for debarment or suspension. The term "principals" is defined to include contracting companies' officers, directors, owners, partners, and persons having management or supervisory responsibilities over government contracts.

In the words of the procurement officials who have approved this new requirement, it works a "sea change" from the existing system of voluntary disclosure of contractor fraud and misconduct and mimics the stringent disclosure regimes adopted for banks and public companies. In urging adoption of a mandatory disclosure regime, the Department of Justice and federal agencies' inspectors general contended that the existing voluntary disclosure policy has been largely ignored by federal contractors.

Contractors should *not* automatically disclose every potential violation relating to the government contract. The term "credible evidence" implies that contractors have the opportunity to conduct a preliminary internal investigation of the facts before determining whether or not disclosure to the federal agency's OIG is necessary. Contractors would be wise to avail themselves of this opportunity to undertake a prompt, thorough, and independent internal investigation of alleged wrongdoing, a measure of diligence they have a fiduciary duty to their owners or shareholders to undertake in any event.

How should contractors respond to this regulatory "sea change"? First and foremost, contractors should not be caught by surprise when the rule becomes effective on December 12, 2008. They should consider the following questions *before* they are confronted with reported violations relating to the contract:

- Does a company compliance program with adequate internal reporting mechanisms exist?
- Have adequate resources been allocated to conduct internal investigations of reported violations?
- Who will determine whether disclosure under the FAR is required?
- How should disclosure be made to the agency OIG?
- Who should make the disclosure?
- How will the resulting government investigation be managed?
- How will public relations consequences be handled?

Federal contractors should also consider legal consequences of mandatory reporting, including the effect of disclosure on the preservation of attorney-client privilege, self-incrimination, preservation of company defenses to government claims (*e.g.*, for recoupment), and maintenance of coverage under applicable insurance policies.

Endnotes

[1] *See* FAR 52.203-13 and FAR 52.203-14.

For assistance in this area, please contact one of the attorneys listed below or any member of your Mintz Levin client service team.

Jonathan T. Cain
Government Contracts Practice Group
(202) 585-3508
JTCain@mintz.com

Benjamin B. Tymann
Corporate Compliance and Internal Investigations Practice Group
(617) 210-6853
BBTymann@mintz.com

Peter A. Chavkin
(212) 692-6231

PChavkin@mintz.com

William "Mo" Cowan
(617) 348-3003
WMCowan@mintz.com

Thomas S. Crane
(617) 348-1676
TSCrane@mintz.com

Steve Ganis
(617) 348-1672
SGanis@mintz.com

Michael S. Gardener
(617) 348-1642
MSGardener@mintz.com

John K. Markey
(617) 348-1686
JMarkey@mintz.com

Tracy A. Miner
(617) 348-1694
TMiner@mintz.com

Bridget M. Rohde
(212) 692-6883
BMRohde@mintz.com

Kristen S. Scammon
(617) 348-4429
KSScammon@mintz.com

McKenzie E. Webster
(617) 210-6856
MWebster@mintz.com
