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CLIENT ALERT:

NEW FAR REQUIREMENTS FOR MANDATORY DISCLOSURE

On December 12, 2008, a major revision to the Federal Acquisition Regulation went into effect with far-reaching consequences for every entity that has a federal government prime or subcontract. The Federal Register notice accurately describes this modification as a "'sea change' in the fundamental approach to compliance followed by the Government."

As a practical matter, the new FAR provisions will require **every** contractor to disclose to an Office of Inspector General ("OIG") all "credible evidence" related to a government contract of: (1) violations of criminal law involving fraud, conflict of interest, or bribery; (2) violations of the civil False Claims Act; or (3) significant overpayments. This mandatory disclosure obligation applies to violations or overpayments occurring after December 12 and to violations or overpayments that occurred before that date that relate to any contract that has not been closed out for at least three years.

The new FAR provisions also require nearly all companies that do business with the Federal Government, either directly of indirectly, to enhance their ethics programs to increase their ability to uncover violations and overpayments that will need to be disclosed to the IG.

Rogers Joseph O'Donnell's Government Contracts Practice Group presents this overview of the new mandatory disclosure regime to assist government contractors in planning their compliance efforts. Application of these changes to the business of a particular contractor will require a careful analysis of the new FAR provisions and the 26-page preamble that accompanied the announcement of the final rule in the Federal Register, as well as an understanding of the various agencies' efforts to implement the new requirements. We provide the attached summary as a starting point for understanding the new disclosure environment for federal contractors.

We are ready to answer any specific questions you may have about application of the new requirements to your particular business. Please feel free to contact any of the shareholders in the Rogers Joseph O'Donnell Government Contracts Practice Group:

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NEW FAR REQUIREMENTS FOR MANDATORY DISCLOSURE AND INTERNAL CONTROL SYSTEMS

This Client Alert addresses the critical issues raised by the new FAR mandatory disclosure system. 73 Fed. Reg. 67064 (“FR”).

First, it will look at how the mandatory disclosure requirements apply, focusing on which contractors will be subject to each set of requirements. Second, it will examine what must be disclosed, when, and to whom, and the requirement of full cooperation with the OIG’s response to the disclosed evidence. Third, it will go over the details of the new internal control system requirements, focusing on the provisions that will require contractors to seek to uncover disclosable evidence of misconduct. Finally, the Alert will look at the interplay between these new requirements and existing laws affecting government contractors, including past performance evaluation requirements, the Freedom of Information Act, the False Claims Act, and Sarbanes-Oxley.

I. Mandatory Disclosure

A. Sources of the Requirement

The obligation for mandatory disclosure requirement is created by three interrelated provisions: (1) the changes to FAR Part 9 that make the failure to disclose violations a basis for suspension and debarment; (2) the new contract clause at FAR 52.203-13(b)(3)(i), which is required in all major contracts in excess of $5 million with a duration of more than 120 days, that imposes a duty to disclose and an elevated obligation to use due diligence to discover violations that must be disclosed; and (3) the new clause at FAR 52.203-13(c), which applies to all such major contracts except those for commercial items or with small businesses, that requires an enhanced internal control system patterned after the federal sentencing guidelines including a duty to “facilitate discovery of improper conduct in connection with government contracts.”

Although there are some wording differences, it appears that the primary difference among the three provisions is the extent of the contractor’s obligation to ferret out violations. Once the violation or overpayment is known to the contractor’s management, however, the duty to disclose is largely the same.

1. Disclosure Based on Avoiding Suspension and Debarment

The overarching obligation comes from the provision in the revised FAR that creates a new basis for suspension or debarment -- the failure to timely disclose credible evidence known by a “principal” of the company of a violation or significant overpayment. For purposes of the suspension and debarment provisions, the term “contractor” is defined as any party that submits an offer or is awarded a contract with the federal government and any subcontractors to such a party, of any tier. FAR 9.403. It also applies to anyone who

"conducts business, or reasonably may be expected to conduct business, with the Governmental or as an agent or representative of another contractor." *Id*. Thus, the implementation of the mandatory disclosure requirement through the new debarment and suspension rule effectively extends the reach of the mandatory disclosure requirement to all federal government contractors and subcontractors at any tier[1].

It is also clear that the cause for suspension and debarment applies even where the new contract clause (discussed below) is not included in the contract. The preamble to the new rule explained that "the failure to timely disclose as a cause for suspension/debarment is independent of the inclusion of the contract clause in the contract or the establishment of an internal control system." FR at 67075. Thus, this obligation applies immediately to all contractors, even before they receive a contract or modification containing the new clause. As noted below, the duty to disclose applies to violations on current contracts and contracts that were not closed out as within the past three years.

As a result, many contractors are now formally surveying their "principals" (see discussion of that term below) to determine whether they are aware of conduct that would constitute a violation on contracts that were not closed within the last three years (*i.e.* as of December 13, 2005).

2. Disclosure Based on the New Clause at FAR 52.203-13 (b)(3)(i) for all Major Contractors

The mandatory disclosure requirement in FAR 52.203-13 (b)(3)(i) will be included in contracts entered into or modified after December 12 that are worth more than $5 million with a duration of performance of more than 120 days. FAR 3.1003 (a). This clause must also be flowed down to all subcontracts over $5 million with a performance duration of more than 120 days. FAR 52.203-13(d).

Accompanying this duty to disclose, the FAR clause requires the contractor to "Exercise due diligence to prevent and detect criminal conduct." FAR 52.203-13 (b)(2)(i). While that obligation is not further defined, it would likely require that the contractor go below the level of "principal" in seeking to detect criminal conduct, thereby creating an elevated obligation of inquiry than that related to the suspension/debarment provisions described above. It may also permit the Government to argue that the contractor was responsible for a failure to disclose violations that would have been detected through the exercise of due diligence as well as those that actually were detected.

To determine whether a contract is over the $5 million threshold, the government will look at the maximum quantity of supplies or services that could be acquired under the contract, including all options. FAR 1.108(c). The preamble directly addresses the

[1] The suspension and debarment provisions of FAR, however, are not applicable to work on state or local government contracts, including those financed with federal grants.

issue of how the $5 million threshold applies to Federal Supply Schedule contracts: "if it is anticipated that the dollar value of orders on an FSS contract will exceed $5 million, then this clause is included in the basic contract against which orders are placed." FR at 67085.

The original version of FAR 52.203-13 exempted commercial and overseas contracts, but Congress objected to this limitation and passed a statute in the summer of 2008 requiring mandatory disclosure for those two categories of contracts as well. In addition, the new clause will also apply to small businesses that have a single contract worth more than $5 million and lasting more than 120 days, which will contain the new FAR clause.

3. Enhanced Internal Control Procedures to Facilitate Discovery of Violations

Major contracts, other than contracts with small businesses or for commercial items, will include a FAR provision that requires adoption of an internal control process that is patterned on federal sentencing guidelines (see Part II below). Among other factors, the internal control process must "establish standards to facilitate timely discovery of improper conduct in connection with Government contracts." FAR 52.203-13(c)(2)(i)(A). The Government expects that this enhanced internal control system will uncover more violations that will be subject to disclosure. Beyond that, it appears that the disclosure obligation remains the same once the violation becomes known to the company's principals.

B. What is to be disclosed

Under the mandatory disclosure system, contractors must disclose evidence of (1) certain types of misconduct; (2) that is credible; (3) that is known to principals of the contractor; (4) that is related to any federal contract awarded to the contractor, or subcontracts thereunder (5) as long as the relevant contract is either current or was completed within the past three years. We will address each of these elements in turn.

1. Types of Misconduct to be Disclosed

Under the mandatory disclosure regime, contractors will have to disclose three types of misconduct: (1) violations of criminal law involving fraud, conflict of interest, and bribery; (2) violations of the civil False Claims Act; and (3) significant overpayments.

The new FAR provisions provide only a general description of which types of violations of criminal law must be disclosed. Disclosures are required for "a violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code." FAR 3.1003(a)(2); 9.406-2(b)(1)(vi)(A); 9.407-2(a)(8)(i); 52.203-13(b)(3)(i)(A); 52.203-13(c)(2)(ii)(F). The preamble does not attempt to list the particular provisions of Title 18 that qualify. It should be noted that the disclosure obligation extends beyond violations by contractor employees, to include violations by a contractor's agents and subcontractors. FAR 52.203-13(b)(3)(i); 52.203-13(c)(2)(ii)(F).

Violations of any part of the Civil False Claims Act, 31 U.S.C. §§ 3729-33, are subject to mandatory disclosure. FAR 3.1003(a)(2); 9.406-2(b)(1)(vi)(B); 9.407-2(a)(8)(ii); 52.203-13(b)(3)(i)(B); 52.203-13(c)(2)(ii)(F). As with criminal violations, the contractor must report civil False Claims Act violations by its own employees, its agents, and its subcontractors.

The requirement for disclosure of "significant overpayments" is found in the new debarment and suspension rules. For many years, payment clauses have required contractors to notify the government if the contractor becomes aware of an overpayment, regardless of its significance. *See e.g.*, FAR 52.212-4, 52.232-25, 52.232-26, 52.232-27. It is apparent from the preamble that the basis of debarment or suspension for failing to report a significant government overpayment is tied to the contractor's obligations under these longstanding clauses and not a new disclosure obligation on the contractor's part. What is new is that a contractor could be suspended or debarred for failing to disclose a "significant overpayment". The final rule added a materiality standard by limiting disclosure to "significant" contract overpayments. The preamble states that the term significant "implies more than just dollar value and depends on the circumstances of the overpayment as well as the amount…[and] it is within the discretion of the suspension and debarment official to determine whether an overpayment is significant…" FR at 67080. The final rule also creates an exemption for disclosure of significant overpayments that result from contract financing payments. The preamble explains that financing payments are often based on estimates, and are better resolved as an issue of contract administration. *Id.* Overall, the preamble sums up the overpayment rule as being "aimed at the type of overpayment that the contractor knows will result in unjust enrichment, and yet fails to disclose it." *Id.*

2. Credible Evidence Standard

A contractor is only required to disclose credible evidence of a violation of one of the relevant criminal laws, a violation of the Civil False Claims Act, or a significant overpayment. The credible evidence standard was introduced in the final rule as a means of reducing the number of disclosures that will be required. The original version of the rule required disclosure whenever a contractor had "reasonable grounds to suspect a violation of criminal law." The preamble explains that the Justice Department recommended narrowing the standard after discussion with industry representatives. FR at 67073. Other than stating that the new standard was higher than the old "reasonable grounds to suspect" standard, the preamble provides no guidance of when evidence should be considered "credible." *Id.*

The requirement to disclose "credible evidence of a violation" of a criminal law or the Civil False Claims Act indicates that the contractor takes significant risks in deciding that a disclosure was not required because of a legal theory that is subject to challenge by the Justice Department. A contractor must disclose more than violations of a law; it must disclose **credible evidence** of violations of a law. The government will expect that contractors will make disclosures even if they are not certain that the conduct has resulted in a violation.

The need to read the disclosure requirement more broadly is particularly important in the False Claims Act context. In the comments on the proposed rule, contractors complained that the False Claims Act was subject to contradictory interpretations that make violations difficult to define. The FAR Councils response in the preamble states that they "do not agree that the requirements of the civil FCA cannot be reasonably ascertained and understood by contractors." FR at 67081. The preamble does concede, however, that "Genuine disputes over the proper application of the civil FCA may be considered in evaluating whether the contractor knowingly failed to disclose a violation of the civil FCA." *Id*. Nevertheless, a contractor will be in a very difficult position if it decides to not disclose credible evidence of an act that the Justice Department would consider to be a violation of the False Claims Act, and the Justice Department later learns of that evidence through a *qui tam* whistleblower.

3. Knowledge By a Principal of the Contractor

The new FAR mandatory disclosure provisions only require the disclosure of violations and significant overpayments that are known to a "principal" of the contractor. The preamble explains that the government is interested in disclosure of a principal's actual knowledge, and does not require disclosure of something that a principal should have known. FR at 67079.

The new rule defines "principal" 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 similar positions)

FAR 52.209-5(a)(2). The examples of persons with primary management or supervisory responsibilities within a business entity in the language of the rule itself indicate that there should be relatively few "principals" within a company, each of whom would be in charge of a large part of the contractor. Based on that language, the contractor should be able to identify the limited number of people who are "principals", unless the contractor has multiple owners or partners, or is generous in distributing the title of officer or director.

Nevertheless, the preamble suggests that the OIGs will be interpreting the definition of "principal" broadly to include all significant positions of responsibility. It notes that "this definition should be interpreted broadly, and could include compliance officers or directors of internal audit, as well as other positions of responsibility." FR at 67079. This specific emphasis on compliance officers and internal auditors demonstrates that the OIGs will expect that contractors will disclose all credible evidence of misconduct uncovered through the operation of the internal control system, and cannot avoid disclosure by failing to report that evidence to the highest levels of company management.

4. Relationship to a Federal Contract Awarded to the Contractor, Subcontracts Thereunder, or a Subcontract to Which the FAR Contract Clause Has Been Flowed Down

A contractor is required to disclose violations and overpayments related to any federal contract it performs. The mandatory disclosures required by the detailed internal control system and the new debarment and suspension rules cover all such contracts, not just the contracts containing the new FAR clause. FAR 3.1003(a)(2); 52.203-13(c)(2)(ii)(F). In other words, once there is a triggering clause in any contract, the contractor's obligation to disclose extends to all contracts.

The preamble makes clear that there is no obligation to report violations known about other contractors' contracts or subcontracts. FR at 67073. But, a contractor is also required to disclose credible evidence of violations and overpayments by subcontractors under its federal contracts. FAR 3.1003(a)(2); 52.203-12(c)(2)(ii)(F). But it is only required to disclose known violations by the subcontractor, and the prime contractor is not required to review or approve subcontractor internal control systems. FR at 67084.

A major subcontractor on a federal contract can take on an independent mandatory disclosure requirement, even if it has no direct contracts with the government. FAR 52.203-13 must be flowed down to all subcontracts that meet the same threshold as the prime contract: a value in excess of $5 million and performance period of more than 120 days. FAR 52.203-13(d)(1). When subcontractors are required to make disclosures, they are required to disclose directly to the agency OIG, and not through the prime contractor. FR 67076.

The preamble also clarifies that the disclosure requirement in the clause applies only to contracts, and does not apply to federal grants recipients, or to contracts awarded using grant money. FR at 67084.

5. Related to All Current Contracts and Contracts Closed Out Less Than Three Years Ago

The new mandatory disclosure scheme requires disclosure of present knowledge of credible evidence of past violations and overpayments. As a result, information learned after the rule becomes effective about misconduct that occurred prior to the effective date still must be disclosed to the government. The new FAR rules require disclosure of earlier misconduct as long as it is related to a contract that is still active or that was closed out within the last three years. FAR 3.1003(a)(2); 52.203-13(c)(2)(ii)(F)(*3*).

This continuing obligation to disclose should not be confused with a statute of limitations. The obligation to disclose is determined not by the date of the misconduct, but by the status of the contract to which the misconduct relates. Certain contracts, such as Federal Supply Schedule contracts, can stay active for periods as long as 10 years. Delays in the processing of final payments on completed contracts will lengthen the required disclosure

period, because the three year cutoff of disclosure obligations does not begin to run until final payment is made.

Furthermore, any current knowledge of past misconduct that has not yet been disclosed must be disclosed shortly after the December 12, 2008 effective date, if that misconduct is related to contracts that are currently open, or were closed within the last three years. The disclosure requirement goes into effect on December 12, regardless of whether or not the FAR contract clause is in any contract, because of the debarment and suspension rule. *See* FR at 67074. At a minimum, contractors should do an inventory of the knowledge of their principals of prior misconduct to determine if anything must disclosed after the rule becomes effective. If a principal now knows of any violations or overpayments, then the contractor must determine if it relates to a contract that was not closed out before December 12, 2005. This also means that a contractor should conduct a prompt review of all completed internal investigations that have not been disclosed to an agency OIG to determine whether they must be disclosed now.

C. When Disclosures Should be Made

The mandatory disclosure rules require "timely" disclosure of credible evidence of violations, but do not set any specific boundaries on what would be considered a timely disclosure. *See, e.g.,* FAR 3.1003(a)(2); 52.203-13(b)(3)(i).

The preamble has clarified, however, that the obligation to disclose does not arise until the contractor has conducted a sufficient investigation to determine whether the evidence of a violation or overpayment is credible. The FAR Councils acknowledge that time will be required to investigate credibility of evidence. According to the Councils, the credible evidence standard 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." FR at 67073. The preamble stated unequivocally that "[u]ntil the contractor has determined the evidence to be credible, there can be no 'knowing failure to timely disclose.'" FR at 67074.

On the other hand, the preamble does not make clear how much investigation may be completed before the contractor is obliged to disclose its results. In general, the preamble demonstrated that the government does not want to be overwhelmed with baseless allegations. But, an OIG is unlikely to tolerate a contractor waiting to disclose until after it completes a full internal investigation, once it had already verified the credibility of the evidence of a violation. According to the preamble, the credible evidence standard "does not impose upon the contractor an obligation to carry out a complex investigation, but only to take reasonable steps that the contractor considers sufficient to determine that the evidence is credible." *Id.* To avoid questions about the timeliness of a disclosure, contractors should promptly initiate investigations of allegations of misconduct, in order to have enough time to complete a thorough investigation if necessary before disclosure to the government.

A contractor should also consider making a preliminary disclosure, even if its investigation is not completed, stating that the disclosure will be supplemented as further information is assessed.

D. To Whom Disclosures Must Be Made

Contractors should make all required disclosures to the relevant agency OIG, with a copy to the contracting officer responsible for the contract. *See* FAR 52.203-13(b)(3)(i); 52.203-13(c)(2)(ii)(F). Although the debarment and suspension mandatory disclosure provisions require disclosure to "the Government" rather than specifically to an agency OIG (*see* FAR 9.406-2(b)(vi); FAR 9.407-2(a)(8)), a contractor should not use this language as a reason to avoid disclosure to the relevant OIG. A contracting officer that is notified of a violation of the relevant criminal laws or the False Claims Act, the contracting officer is obliged to coordinate the matter with the agency OIG. FAR 3.1003(b)(1). Thus, the proper OIG eventually will be notified of any mandatory disclosure in any event. Because of the government's expectation that disclosures will be made to the agency IG, disclose to any other government official without copying the OIG will most likely be counterproductive and lead to greater scrutiny of the disclosed evidence. On the other hand, disclosures to contracting officials prior to December 12, 2008 for past conduct should be sufficient to meet the mandatory disclosure requirements of the new regulations, since the requirement of disclosure to the IG did not come into effect until December 12.

The new disclosure requirements directly address the problem of which agency's OIG must be notified when a procurement instrument used by multiple agencies is involved. For contract vehicles used by multiple agencies, such as government wide acquisition contracts or the Federal Supply Schedule, the contractor must notify the OIG of the ordering agency and the IG of the agency responsible for the basic contract. Both agencies' contracting officers must also be notified. FAR 52.203-13(b)(3)(iii); 52.203-13(c)(2)(ii)(F)(*2*).

The major contracting agencies have already begun to establish specific mechanisms to process the expected flow of disclosures from their contractors. The DoD, GSA, and NASA have all set up websites that will accept on-line disclosures. The DoD's site can be found at www.dodig.mil. The GSA has already drafted a standard disclosure form, available at oig.gsa.gov/integrityreport.htm. The form will require the following information: who is submitting the form and is authorized to speak for company; identification of the relevant contract identification; a description of the loss sustained to the Government; and a description of the violation or overpayment, including identification of the persons who were involved, how long they were involved, and what happened. NASA's OIG is also setting up a web disclosure site similar to the those of the DoD and the GSA.

E. Full Cooperation With the Office of Inspector General's Response to Disclosure

Upon receipt of the disclosure, the OIG will decide whether to do a further investigation of the violation or overpayment. The Department of Justice does not have a formal role in other agencies' review of disclosures, but a contractor should nevertheless assume that the Department of Justice will be consulted, since the Inspector General Act requires that IGs notify the Department of Justice of potential crimes. If there is actually a referral to the Department of Justice, the contractor will not be notified until the Department of Justice has completed its investigation.

The DoD has announced that its review of mandatory disclosures will be performed by the same group that currently handles voluntary disclosures. That group includes criminal investigation teams and fraud counsel. The review of mandatory disclosures will take place at the central DoD OIG, rather than by the Inspectors General for the military services or other agencies within the DoD. The DoD has also announced that, unlike the way it handled voluntary disclosures, it will not conduct an investigation into every disclosure it receives. The DoD's criminal investigators will determine whether to pursue an investigation, and otherwise the DoD will try to resolve issues administratively through the Contracting Officer.

GSA and NASA are in the process of establishing teams that will determine whether particular mandatory disclosures require further investigation. NASA's OIG is coordinating closely with the procurement community to determine how best to respond to disclosures as they come in.

No matter how the relevant OIG decides to handle a disclosure, a contractor is required to provide full cooperation. FAR 52.203-13(c)(2)(ii)(G). The new rules provide a specific definition of full cooperation:

> disclosure to the Government of the information sufficient for law enforcement to identify the nature and extent of the offense and the individuals responsible for the conduct. It includes providing timely and complete response to Government auditors' and investigators' requests for documents and access to employees with information.

FAR 52.203-13(a). The preamble elaborates further that "cooperation should include all information requested as well as all pertinent information known by the contractor necessary to complete the investigation, whether the information helps or hurts the contractor." FR at 67078.

Upon learning of possible violations of the law, a contractor may well undertake, through counsel, an internal investigation of the allegations. The investigation will include gathering and reviewing relevant documents and interviewing key individuals potentially involved in wrongdoing. The investigation may well result in a written report to

the contractor or, in the case of a publicly traded company, to a special board assigned the task of investigating the allegations.

According to the definition of full cooperation, the obligation can be met without waiving attorney-client privilege and attorney work product protections. FAR 52.203-13(a). But in discussing this limitation, the preamble emphasizes that **facts** are not protected by the attorney-client privilege or work product doctrine. FR at 67077. The preamble also addressed other expectations that the government will have from contractors meeting their full cooperation obligation. The government will not interfere with indemnification of employees for legal costs, as long as that indemnification is mandated by state law or by contract *Id.* The government may require a contractor employee who is responsible for a violation to be removed from federal contracts, and may also expect such an employee to be fired. *Id.*

Because the obligation of full cooperation will likely require information obtained from employees during interviews to be disclosed to the government, a contractor may need to provide appropriate warnings before questioning employees. The preamble claims that "[n]othing in the proposed rule requires administration of 'Miranda' warnings. The rule does not place contractors in the role of law enforcement officers." FR at 67072. Nevertheless, the ethical obligations of attorneys representing a contractor during an interview may require the attorneys to inform employees of the possibility that the information being collected statements will be disclosed to the government, and of their right to separate counsel. An employee's failure to cooperate, however, should not be imputed to the contractor. Overall, the preamble acknowledges that "cooperation to be measured is the cooperation of the organization itself, not the cooperation of individuals within the organization." FR at 67078.

The government's investigation may well last for some time, even years, as government investigators and prosecutors marshal evidence and interview witnesses. At some point, the government may identify individual and corporate targets. An effective and thorough internal investigation by counsel before disclosure will not only provide an assessment of the contractor's potential criminal exposure but produce materials which if disclosed to the government, may be helpful in convincing it that the contractor is presently responsible to obtain government contracts.

II. Internal Control System Requirements

The new provisions also call for the inclusion of the provisions in FAR 52.203-13(c) for all contracts that meet the $5 million/120 day threshold, to adopt "an ongoing business ethics awareness and compliance program." FAR 52.203-13(c)(1). Small businesses and contracts that are for the acquisition of commercial items are specifically exempted from the requirement to adopt these detailed internal control system requirements. FAR 52.203-13(c). But, a single non-commercial item contract over $5 million will force a non small business contractor to adopt the clause's detailed internal control system.

Under the clause, a contractor has 90 days after receiving its first contract including the new FAR contract clause, to establish an enhanced internal control system, unless it can convince the contracting officer that it needs longer. FAR 52.203-13(c).

A. Requirements Based on Sentencing Guidelines

The FAR sets forth certain minimum requirements for the internal control system. The source for these minimum requirements is § 8B2.1 of the United States Sentencing Guidelines on the sentencing of organizations. Section 8B2.1 enumerates the requirements for an "effective compliance and ethics program." For purposes of determining an advisory fine amount, an organization is given credit if it maintained an "effective compliance and ethics program." While the FAR does not adopt the language of the sentencing guidelines verbatim or all the requirements of § 8B2.1, the FAR requirements are modeled after § 8B2.1 and sources interpreting that section, including application notes to § 8B2.1 and case law, may be helpful in interpreting the FAR requirements.

B. Elements

The internal control system set forth in the FAR requires the following elements: (1) mandatory disclosure; (2) periodic reviews of company practices, procedures, policies and internal controls; (3) reporting mechanism that offers anonymity; (4) disciplinary action for improper conduct; (5) assignment of responsibility at a sufficiently high level of the organization; (6) devotion of adequate resources to ensure effectiveness of the ethics awareness and compliance program; (7) reasonable efforts to exclude individuals who have been engaged in illegal or unethical conduct from the contractor's senior management; and (8) periodic assessments of risk of criminal conduct. FAR 52.203-13(c)(2)(ii).

C. Obligation to Uncover Violations

As described above, these internal control system requirements impose an active obligation on contractors to uncover disclosable violations of criminal law and the civil False Claims Act. These include a requirement for monitoring and auditing to detect criminal conduct (FAR 52.203-13(c)(2)(ii)(C)(*1*), and establishing an internal anonymous reporting mechanism (FAR 52.203-13(c)(2)(ii)(D). The preamble states that "standard business practice for 'monitoring and auditing to detect criminal conduct' which conforms to generally accepted accounting principles should be sufficient." FR at 67068. Based on these obligations, the Inspectors General will expect that contractors who have instituted the mandated internal control system will be making regular disclosures of violations.

D. Training

The FAR provision also requires training, but provides only vague guidelines for the training program:

> This program shall include reasonable steps to communicate periodically and in a practical manner the Contractor's standards and procedures and other aspects of the Contractor's business ethics awareness and compliance program and internal control system, by conducting effective training programs and otherwise disseminating information appropriate to an individual's respective roles and responsibilities.

FAR 52.203-13(c)(1)(i). No specific content is required. The clause does direct that the training be provided to the contractor's principals and employees, and as appropriate, to the contractor's agents and subcontractors. FAR 52.203-13(c)(1)(ii). But there is no guidance as to when providing training to agents or subcontractors would be appropriate.

E. Continuing Obligations on Small Businesses and Commercial Contractors

Even though small businesses and commercial contractors are exempt from the detailed internal control system requirement of FAR 52.203-13(c), they are still required to meet certain business ethics requirements if they contract with the government. Under the FAR, all contractors must have a written code of business ethics and conduct. FAR 3.1002(b). All contractors

> should have an employee business ethics and compliance training program and an internal control system that—
>
> > (1) Are suitable to the size of the company and extent of its involvement in Government contracting;
> >
> > (2) Facilitate timely discovery and disclosure of improper conduct in connection with Government contracts; and
> >
> > (3) Ensure corrective measures are promptly instituted and carried out.

Id. If a small business or commercial contractor does have a contract containing FAR 52.203-13, the contractor takes on the additional obligation to: "(i) Exercise due diligence to prevent and detect criminal conduct; and (ii) Otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law." FAR 52.203-13(b)(2). Thus, small businesses and commercial contractors do not need to meet the formal requirements of the detailed internal control system from 52.203-13(c) to be described below, but they do have to meet the FAR's other internal control system requirements.

III. Relationship Between the New FAR Provisions and Other Laws

A. Government Collection of Past Performance Information

The FAR requires that the government prepare past performance assessments on completed contracts to be used in future source selections. FAR 42.1502. Evidence

provided to an OIG as part of the mandatory disclosure program is likely to end up in the government's past performance information systems, because that information will also be provided to the relevant contracting officers. Contractors do have an opportunity to comment on adverse past performance information (FAR 42.1503(b)), but it will be difficult to remove information that the contractor has itself determined to be credible evidence of violations of criminal law, the False Claims Act, or significant overpayments. Thus, mandatory disclosures could make it more difficult for the contractor to obtain future business from the government.

On the other hand, failure to disclose can now also be considered as relevant past performance information. One of the new FAR provisions in the final rule was an addition to the list of relevant past performance information: "the contractor's record of integrity and business ethics." FAR 42.1501; *see* FR 67091. With this new provision, failure to disclose could have a greater impact on past performance evaluations than a mandatory disclosure.

Overall, the impact of the mandatory disclosure regime on past performance information could lead to a *de facto* debarment in which past performance information created by a mandatory disclosure will make it impossible for a contractor to obtain future work from the government. The government claims that one of the reasons that suspension and debarment provisions were added as a mechanism for enforcing mandatory disclosures was to create a centralized review of responsibility by suspension and debarment officials that could help prevent individual contracting officers from carrying out a *de facto* debarment. According to these government officials, the suspension and debarment process could provide contractors with an opportunity to explain how the disclosed information does not preclude present responsibility to perform federal contracts. Nevertheless, individual contracting officers conducting source selections will still have their own duty to assess present responsibility based on the past performance information available to them. Thus, it is unclear how the additional review by suspension and debarment officials will provide any benefit to contractors.

Contractors will be required to follow up on mandatory disclosures by monitoring the information that appears in the past performance information systems available to source selection officials. Contractors will need to be prepared to present arguments in connection with future source selections explaining how that evidence of past violations -- that the contractor had assessed to be credible -- has no bearing on their current responsibility to perform the new work.

B. Freedom of Information Act

Contractors will want to avoid public dissemination through FOIA of information that they themselves describe as credible evidence of violations of law or significant overpayments. The new FAR provisions do make an attempt to support contractors' efforts to restrict the public release of mandatory disclosures in response to

FOIA requests. The new FAR contract clause adds language encouraging the government to assist contractors seeking to apply existing FOIA exemptions to prevent disclosure:

> The Government, to the extent permitted by law and regulation, will safeguard and treat information obtained pursuant to the Contractor's disclosure as confidential where the information has been marked ''confidential'' or ''proprietary'' by the company. To the extent permitted by law and regulation, such information will not be released by the Government to the public pursuant to a Freedom of Information Act request, 5 U.S.C. Section 552, without prior notification to the Contractor.

FAR 52.203-13(b)(3)(ii). The preamble implies that this protection should also cover mandatory disclosures that are not based on the FAR contract clause. FR at 67086.

Despite the government's pledge of support, contractors should expect that significant information in mandatory disclosures will be released to the public through FOIA. The new provisions do not create any new exemptions to FOIA release. They only reinforce existing exemptions. FOIA case law provides a relatively narrow definition of information that may be withheld from disclosure as "confidential" or "proprietary." Judicial interpretations of those exemptions also make results of particular FOIA litigation difficult to predict. In light of the new administration's strong emphasis on transparency in federal contracting, it would be fair to anticipate that the trend will be towards disclosure of a broader range of contractor information under FOIA, particularly when that information provides evidence of contractor misconduct.

C. False Claims Act

The mandatory disclosure regime is specifically designed to improve the Justice Department's ability to bring False Claims Act lawsuits against contractors. The new system has as an explicit goal that contractors provide the government with credible evidence of violations of the Act, and there is no restriction on the Justice Department using that information as the basis of civil lawsuits against the disclosing contractors.

At the same time, mandatory disclosures, combined with the operation of more robust internal control systems that create an atmosphere encouraging uncovering of potential fraud and reporting it using anonymous hotlines, will also increase the frequency of *qui tam* False Claims Act lawsuits brought by whistleblowers. A *qui tam* relator will benefit significantly from a contractor's own admission that a disclosure includes credible evidence of a False Claims Act violation. Under the current False Claims Act, contractors may be able to cut off some of the potential *qui tam* relators by taking advantage of the public disclosure jurisdictional bar. In certain circumstances, contractors can qualify for that defense by making mandatory disclosures public through media reports. But it is very uncertain how long that defense will be available. Amendments to the False Claims Act that were considered very seriously by the last Congress, and will be taken up again when the new Congress convenes, could effectively eliminate that defense, as well as other defenses frequently employed in *qui tam* False Act litigation. Overall, it is likely that this mandatory

disclosure regime and the revisions to the False Claims Act will significantly increase contractors' risks on *qui tam* actions going forward.

D. Sarbanes-Oxley

Contractors will need to integrate their efforts to meet the new internal control system requirements with their efforts to comply with Sarbanes-Oxley. The preamble claims that the new internal control system requirements should help contractors subject to Sarbanes-Oxley comply with that Act. FR at 67067. That comment ignores the different requirements of the two compliance systems, and the different assessments made regarding the need for disclosures for securities law purposes and the need for disclosures made for government contracts purposes. Contractors will need to coordinate the necessary expertise in corporate and government contract law to avoid over disclosure or under disclosure under either scheme.