

CLIENT ADVISORY

FINAL COMPLIANCE RULE REQUIRES BROAD MANDATORY DISCLOSURE BASED ON “CREDIBLE EVIDENCE” OF WRONGDOING

On November 12, 2008, the Civilian Agency Acquisition Council and the Defense Acquisition Council (the Councils) published a Final Rule amending the Federal Acquisition Regulation (FAR) to increase the compliance and reporting obligations of federal government contractors and subcontractors.¹ The Final Rule follows two earlier proposed rules² and implements the so-called Close the Contractor Fraud Loophole Act,³ which directed the elimination of certain exceptions contained in the First Proposed Rule. The Final Rule is effective December 12, 2008.

In a move that the Councils acknowledge to be a “sea change,” the Final Rule imposes new requirements for mandatory disclosure when a contractor has “credible evidence” that a principal, employee, agent, or subcontractor has violated the civil False Claims Act (FCA) or has committed certain violations of federal criminal law. These disclosure requirements apply to federal contracts with a performance period of 120 days or more and a value of more than US\$5 million, including Federal Supply Contracts with an anticipated overall value of more than that amount. All government contracts, including those for commercial items and those performed exclusively overseas, are subject to the new requirements. In addition, the Final Rule requires contractors to maintain internal controls to detect and prevent improper conduct in connection with their government contracts. These internal control requirements, however, do not apply to contracts for commercial items or those in which the contractor has represented itself to be a small business concern.

The Final Rule also authorizes suspension or debarment of a government contractor upon the knowing failure by a principal of the contractor to timely disclose “credible evidence” of a significant overpayment under a government contract or subcontract or a violation of certain federal criminal laws or the civil FCA in connection with the award, performance, or closeout of a government contract or subcontract. Although the mandatory disclosure provisions of the Rule apply only to contracts awarded

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¹ 73 Fed. Reg. 67064 (Nov. 12, 2008). The Proposed Rule was originally published on November 14, 2007, 72 Fed. Reg. 64019, and a revised version of the Proposed Rule was published on May 16, 2008, 73 Fed. Reg. 28407.

² See Arnold & Porter Client Advisory, “[New FAR Provisions Mandate Federal Contracts Compliance Plans, Training, and Internal Controls](#),” Nov. 2007 (summarizing the First Proposed Rule); Arnold & Porter Client Advisory, “[New Version of Proposed FAR Rule Would Require Broad Self-Reporting by Government Contractors](#),” May 2008 (summarizing the Second Proposed Rule).

³ Pub. L. No. 110-252.

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after its effective date, the new grounds for suspension and debarment extend to contracts that predate the effective date of the Rule. Like the mandatory disclosure provisions, the new suspension and debarment grounds apply to all federal contractors. The suspension and debarment provisions, the internal control system requirements, and apparently the mandatory disclosure requirements apply for three years after final payment on a contract.

The chart below summarizes the new FAR requirements. It also presents the relevant provisions of the Second Proposed Rule and the corresponding portions of the Preamble and text of the Final Rule.

Second Proposed Rule	Final Rule
<p>Disclosure Obligation:</p> <p>The Proposed Rule provided that contractors must notify the Office of Inspector General (OIG) whenever they have “reasonable grounds to believe” that a violation of federal criminal law or the civil FCA has been committed in connection with the award or performance of the contract or a subcontract.</p>	<p>Final Rule: Contractors must timely disclose, in writing, to the agency OIG, with a copy to the Contracting Office (CO), “whenever, in connection with the award, performance, or closeout of this [prime] contract or any subcontract thereunder, the Contractor has credible evidence” that a principal, employee, agent, or subcontractor of the Contractor has committed: (a) a violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code; or (b) a violation of the civil False Claims Act (31 U.S.C. 3729–3733). FAR 52.203-13(b)(3)(i).</p> <p>Preamble: The Councils replaced the “reasonable grounds to believe” standard with a “credible evidence” standard. According to the Councils, “[t]his term indicates a higher standard, implying 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.” 73 Fed. Reg. 67073.</p>
<p>Who Should Receive Disclosures on Behalf of the Government?:</p> <p>The Proposed Rule required disclosure to cognizant OIG and the CO.</p>	<p>Final Rule: Timely disclosure must be made to the agency OIG, with a copy to the CO. FAR 52.203-13.</p> <p>Preamble: The Councils concluded that the CO is not in a position to evaluate the criminal behavior of individual employees, and that “[b]y mandating disclosure to the OIG, the rule will add weight to the arguments inside a corporation that good business practices in the long run favor compliance and disclosure.” 73 Fed. Reg. 67072.</p>
<p>Application of the US\$5 Million Contract Value Threshold for Mandatory Disclosure:</p> <p>The Proposed Rule did not address whether the US\$5 million threshold applied to Federal Supply Schedule (FSS) contracts—on an order-by-order basis or to the contract value taken as a whole.</p>	<p>Preamble: The Councils clarified that “unless otherwise specified, if the action establishes a maximum quantity of supplies or services to be acquired, the final anticipated dollar value must be the highest final priced alternative to the Government, including the dollar value of all options.” 73 Fed. Reg. 67085.</p>

Second Proposed Rule	Final Rule
<p>Suspension and Debarment: The Proposed Rule added a new ground for suspension and debarment for the “knowing failure to timely disclose” a violation of the civil FCA or federal criminal law in connection with the award or performance of any Government contract or subcontract, or an overpayment on the contract.</p>	<p>Final Rule: The final rule added the following causes for suspension and debarment:</p> <p>“Knowing failure by a principal, until 3 years after final payment on any Government contract awarded to the contractor, to timely disclose to the Government, in connection with the award, performance, or closeout of the contract or a subcontract thereunder, credible evidence of—</p> <p>(A) Violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code;</p> <p>(B) Violation of the civil False Claims Act; or</p> <p>(C) Significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments as defined in 32.001.” FAR 9.406-2 (debarment); <i>accord</i> FAR 9.407-2 (suspension).</p>
<p>Scope of the Obligation to Disclose Overpayments Under the Suspension and Debarment Provisions: The Proposed Rule contained no limitation on the scope of the disclosure obligation.</p>	<p>Final Rule: The suspension and debarment provisions apply to “Significant overpayment(s) on the contract, other than overpayments resulting from contract financing payments as defined in 32.001.” FAR 9.406-2(b)(1)(vi)(C), 9.407-2 (a)(8)(iii).</p> <p>Preamble: The Councils limited the suspension and debarment provisions of the final rule to “significant overpayments, which implies more than just dollar value and depends on the circumstances of the overpayment as well as the amount.” Whether an overpayment is significant is within the discretion of the suspension and debarment official. 73 Fed. Reg. 67080.</p>
<p>Grounds for Suspension and Debarment: Suspension and debarment were possible in the event of a failure to disclose an overpayment on a Government contract or a violation of the civil FCA or certain criminal laws.</p>	<p>Final Rule: The suspension and debarment provisions are triggered by the principal’s failure to disclose “credible evidence of” a violation. FAR 9.406-2(b)(1)(vi), 9.407-2(a)(8).</p> <p>Preamble: Although the final rule now incorporates the “credible evidence” standard into the suspension and debarment provisions, the Councils stated in the Preamble that “the question of timely disclosure will not come up unless the Government independently discovers that there has been a significant overpayment, a violation of the civil FCA, or a violation of Federal criminal law to be disclosed, that the Contractor knew about and elected to ignore. It is unlikely that any contractor would be suspended or debarred absent the determination that a violation had actually occurred.” 73 Fed. Reg. 67078.</p>

Second Proposed Rule	Final Rule
<p>Knowledge Requirement of the New Suspension and Debarment Grounds:</p> <p>The Proposed Rule contained no specificity regarding who within an organization must have “knowledge” sufficient to trigger the reporting requirements.</p>	<p>Final Rule: The Councils revised the suspension and debarment provisions to require disclosure when a “principal” of the company has knowledge of a violation. “<i>Principal</i> means an officer, director, owner, partner, or a person 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 2.101(b)(2).</p> <p>Preamble: The Councils agreed that knowledge cannot be imputed and that the principal must have knowledge of the violation. However, they cautioned that “principal” should be interpreted broadly, and includes compliance officers or directors of internal audit, as well as other positions of responsibility. 73 Fed. Reg. 67076, 67079.</p>
<p>Duration of the Disclosure Requirements:</p> <p>The Proposed Rule was not specific regarding the duration of the disclosure requirements.</p>	<p>Final Rule: Councils agreed to add the phrase “until 3 years after final payment on any Government contract awarded to the contractor” to the provisions for suspension and debarment at FAR 9.406–2(b)(1)(vi) and FAR 9.407–2(a)(8) and the internal control system provisions at FAR 52.203-13(c)(2)(ii)(F).</p> <p>Preamble: The Councils agreed that required disclosure of violations under the suspension and debarment and internal control system provisions should be limited to a period of three years after contract completion, using final payment as the event to mark contract completion. 73 Fed. Reg. 67074.</p>
<p>Should the Disclosure Requirements Cover the Civil FCA?:</p> <p>The Proposed Rule included violations of the civil FCA as part of the mandatory disclosure requirement and the new suspension and debarment grounds.</p>	<p>Final Rule: Violations of the civil FCA remain a required disclosure under the mandatory disclosure requirement and the suspension and debarment provisions, but the trigger has increased from “reasonable probability of a violation” to “credible evidence of a violation.” See FAR 9.406-2(b)(1)(B), 9.407-2(a)(8)(ii), 52.203-13(b)(3)(i)(B).</p> <p>Preamble: The Councils acknowledged that some issues concerning the proper application of the civil FCA remain unsettled, but reasoned that “[g]enuine 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.” 73 Fed. Reg. 67082.</p>
<p>Definition of “Timely” Disclosure:</p> <p>The Proposed Rule was silent as to the meaning of “timely” disclosure under the mandatory disclosure requirement and the suspension and debarment provisions.</p>	<p>Preamble: The Councils stated that they considered and rejected adding a fixed time period for investigation, but noted that 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. 73 Fed. Reg. 67074.</p>

Second Proposed Rule	Final Rule
<p>Interaction of Mandatory Disclosure with the Mitigating Factors Contained in the FAR and the Civil FCA:</p> <p>The Proposed Rule was silent on this issue.</p>	<p>Preamble: The Councils confirmed that the mitigating factors of FAR 9.406–1(a) will continue to be used, and that a contractor’s timely disclosure to the Government will continue to be a mitigating factor in assessing a penalty. Even if disclosure is “mandatory,” the FAR and US Sentencing Guidelines incentives will still be offered to promote compliance. 73 Fed. Reg. 67069, 67073. Likewise, mandatory disclosure would not preclude a contractor from meeting the requirements of the reduced damages provision of the civil FCA. <i>Id.</i> at 67082.</p>
<p>Scope of the Requirement that Contractors Must Ensure “Full Cooperation with any Government Agencies Responsible for Audit, Investigation, or Corrective Action”:</p> <p>The Proposed Rule was silent regarding the inter-relationship of the disclosure requirement to applicable privileges.</p>	<p>Final Rule: “Full cooperation...does not require—</p> <ul style="list-style-type: none"> (i) A Contractor to waive its attorney-client privilege or the protections afforded by the attorney work product doctrine; or (ii) Any officer, director, owner, or employee of the Contractor, including a sole proprietor, to waive his or her attorney client privilege or Fifth Amendment rights...” FAR 52.203-13(a)(2). <p>Preamble: The Councils confirmed that they had added a new definition of “full cooperation” to make clear that the rule does not mandate disclosure of materials covered by the attorney work product doctrine. The Councils also confirmed that, for comparison purposes, it is instructive to refer to the flexible approach in the US Sentencing Guidelines. 73 Fed. Reg. 67077.</p>
<p>Prospective Application of the Rule:</p> <p>The Proposed Rule was silent on whether it applied to contracts entered into prior to the effective date of the rule.</p>	<p>Preamble: The Councils confirmed that the mandatory disclosure requirement is prospective only and that “timely disclosure would be measured from the date of determination of credible evidence or the date of contract award, whichever event occurs later.” 73 Fed. Reg. 67075. However, the new suspension and debarment grounds apply to contracts that predate the effective date of the rule. Timely disclosure for the suspension and debarment provisions “would be measured from the date of determination by the contractor that the evidence is credible, or from the effective date of the rule, whichever event occurs later.” <i>Id.</i></p>

If you would like more information about any of the topics discussed, please contact your Arnold & Porter attorney or:

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