
The revised rule

- Expands the scope of the existing business ethics and conduct clause at FAR 52.203-13 to include disclosures of certain criminal offenses and certain violations of the civil False Claims Act; and
- Makes knowing failure to disclose certain criminal offenses and certain violations of the civil False Claims Act a cause for suspension or debarment;
- Specifies minimum standards for contractor internal control systems, including a commitment to “full cooperation” with Government audits, investigations or corrective actions;
- Makes contracts for commercial items, which are currently exempt from FAR 52.203-13, subject to certain terms of the revised clause and eliminates the exemption for contracts to be performed entirely outside of the United States; and
- Makes knowing failure to disclose certain overpayments a cause for suspension or debarment.

A. Revisions to the Contract Clause at FAR 52.203-13

Disclosure to the IG (FAR 52.203-13(b)(3)(i))

The most significant change is to directly commit the contractor to make “timely” written disclosure to the Inspector General of the contracting agency whenever the contractor has “credible evidence” that a principal, employee, agent or subcontractor of the contractor has committed a violation of

- “Federal criminal law involving fraud, conflict of interest, bribery or gratuity violations” in Title 18 of the U.S. Code (“federal criminal law”) or

The revised clause’s disclosure obligation applies to violations in connection with the award, performance or closeout of prime contracts containing the revised clause, and subcontracts under those prime contracts. (Other disclosure provisions

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discussed below appear to have a broader reach.) Notice of a disclosure to an IG must also be provided to the contracting officer. In the case of GSA Federal Supply Schedule contracts or other government-wide acquisition contracts, disclosure must be made to the IGs of the ordering agency and the agency responsible for the basic contract. Disclosures of covered violations affecting more than one contract are also addressed.

**T**reatment of Contractor Information (FAR 52.203-13(b)(3)(ii))

The revised clause commits the government – “to the extent permitted by law and regulation” – to treat information included in a contractor disclosure that is marked “confidential” or “proprietary” as confidential and to notify the contractor before releasing it under FOIA. (Documents provided in a disclosure may be given to other executive branch components if the information relates to a matter within that component’s jurisdiction.)

**Internal Controls** (FAR 52.203-13(c)(1)-(2))

The revised clause retains the requirement for a code of business ethics and conduct, but puts additional emphasis on periodic communication regarding the contractor’s business ethics awareness, compliance and internal controls programs, and on having “effective training programs.” It expressly requires training for principals and employees, and “as appropriate” agents and subcontractors.

The revised clause also retains the core elements prescribed by the existing clause for an internal control system – systems and procedures to facilitate discovery of improper practices and for implementation of corrective action; periodic reviews of business practices for compliance with the contractor’s standards of business ethics and conduct; an internal reporting mechanism such as a hotline; and disciplinary action for improper conduct.

However, the revised clause expands the contractor’s responsibilities in these areas and specifies “minimum” standards for an internal control system. Those include:

- Assigning responsibility for internal controls at a “sufficiently high level” and providing adequate resources to ensure that the contractor has an effective business ethics compliance program and system of internal controls;

- Performing reasonable due diligence on potential “principals” to find out whether they have engaged in conduct that conflicts with the contractor’s code of business ethics and conduct;

- Prescribing periodic reviews of business practices, procedures, policies and internal controls for compliance with the contractor’s code of business ethics and conduct, including periodic monitoring and auditing to detect criminal conduct and periodic assessments of risks of criminal conduct;

- “Full cooperation” in government audits, investigations or corrective actions (discussed further below); and

- Disciplinary action for both improper conduct and “failing to take steps to prevent or detect improper conduct.”
In addition, this portion of the revised clause appears to take a somewhat broader approach to disclosure than the one set forth in FAR 52.203-13(b)(3)(i), discussed above. Here, disclosures are to be made regarding violations in connection with any prime contract performed by the contractor “or a subcontractor thereunder,” regardless of whether the contract contained the revised clause at FAR 52.203-B. See id. (c)(2)(ii)(F).

**Full Cooperation (FAR 52.203-13(a) & (c)(2)(ii)(G))**

The minimum standards for contractor internal control systems now commit contractors to provide “full cooperation with any government agencies responsible for audits, investigations, or corrective actions.” The new rule defines “full cooperation” as

> 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’ request for documents and access to employees with information.

It goes on to provide that “full cooperation” does not require a contractor to waive its attorney client or work product privileges, or an individual (e.g., a contractor employee) to waive his/her 5th Amendment rights or attorney client privilege. It also does not restrict a contractor from conducting its own internal investigation or defending a “proceeding or dispute arising under the contract or related to a potential or disclosed violation.”

**B. Applicability of the Revised Rule**

Like the current clause, the revised clause is for contracts and subcontracts greater than $5 million and with a performance period of more than 120 days. The revised clause will be included in solicitations (and contracts resulting from them) issued on or after December 12, 2008. The clause will become effective upon award of a contract containing it, although it allows the contractor an additional 90 days after award to establish an internal control system thereunder. However, the regulatory amendments relating to suspension and debarment, discussed below, are scheduled to go into effect on December 12.

**Contracts for Commercial Items**

The current regulation includes an exemption from the clause at FAR 52.203-B for contracts for commercial items. However, as a result of the “Close the Contractor Fraud Loophole Act,” contracts for commercial items (in excess of $5 million) will now be subject to the revised clause’s provisions in paragraph (b)(3) regarding timely disclosure of violations of federal criminal law and the FCA in connection with contracts containing the revised clause. The new rule also makes those contracts subject to the general business ethics commitments in paragraphs (b)(1) and (2) of the clause: namely, they must

(i) have a code of business ethics and conduct that is to be made available to employees engaged in contract performance;

(ii) “[e]xercise due diligence to prevent and detect criminal conduct,” and
(iii) “promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law.”

However, contracts for commercial items are exempt from the provisions in paragraph (c) regarding ethics awareness and compliance programs and internal control systems. Contracts for commercial items also continue to be exempt from the clause at FAR 52.203-14. Display of Hotline Posters.

The commentary accompanying the new rule indicates that contractors should expect to see the new FAR 52.203-13 clause in GSA FSS contracts “if it is anticipated that the dollar value of orders on an FSS contract will exceed $5 million.” See 73 Fed. Reg. at 67085.

Small Businesses

Small business contracts are treated like commercial item contracts. Small businesses are subject to the general business ethics provisions in paragraphs (b)(1) & (2) of the revised clause and the disclosure provisions in paragraph (b)(3), but they are exempt from the ethics awareness and compliance program, and internal control system, provisions in paragraph (c).

Contracts Performed Entirely Outside the United States

The exemption from FAR 52.203-13 in the current regulation for contracts performed entirely outside of the United States has been eliminated (consistent with “Close the Contractor Fraud Loophole Act”). Those contracts continue to be exempt from the hotline poster clause at FAR 52.203-14.

A Cautionary Note

The revised rule also reemphasizes that the policies stated in FAR 3.1002 – that contractors (i) must conduct themselves with the highest degree of honesty and integrity; (ii) should have a written code of business conduct and a compliance training program; and (iii) have an appropriate system of internal controls that is adequate to “discover and disclose” improper conduct and ensure that corrective action is taken, apply “as guidance” to all contractors, even those who may not be subject to the clause at FAR 52.203-13. See FAR 3.1003(a)(1). Further, as discussed below, the new rule provides that such a contractor may be suspended or debarred for knowing failure by any of its principals to timely disclose credible evidence of certain violations of federal criminal law or the FCA. See id. (b)

C. Expanded Causes for Suspension and Debarment

The revised rule also amends FAR 9.406-2 and 9.407-2 to expand the potential causes for suspension or debarment to include knowing failure by any of its principals to timely disclose credible evidence of (i) violations of federal criminal law or the FCA, or (ii) certain “significant overpayments” in connection with any prime contract performed by the contractor or a subcontract awarded thereunder.
Specifically, a contractor may be suspended or debarred where a principal of the contractor knowingly fails to timely disclose credible evidence of violations of federal criminal law or the FCA in connection with contract award, performance or close out, even if the clause at FAR 52.203-13 does not apply. See FAR 3.1003(a)(2). Moreover, since such failures remain a cause for suspension or debarment for a period of up to three years after final payment, see id., they could include a failure to disclose a violation in connection with a contract entered into many years ago. Similarly, FAR 3.1003(a)(3) cites several FAR clauses relating to Government payments and states that a contractor may be suspended or debarred based on a knowing failure of any of its principals to timely disclose credible evidence of “significant” overpayments (other than overpayments resulting from contract financing payments as defined in FAR 32.201), without any express limitation to contracts performed by the contractor. See also, e.g., FAR 52.212-4(j) and 52.232-25(d) (payment clauses regarding overpayments).

D. **Other Provisions**

The revised rule

- Amends FAR 42.1501 to include a contractor’s “record of integrity and business ethics” in the past performance information that may be considered for source selection purposes.

- Continues to make FAR 52.203-13 a mandatory flow-down to subcontracts and extends that to subcontracts for commercial items.

- Retains the clause at FAR 52.203-14, Display of Hotline Posters, for contracts in excess of $5 million. (As noted above, contracts for commercial items and those to be performed entirely outside of the United States remain exempt from this clause.)

The revised rule also defines several terms for purposes of FAR subpart 3.10 and the clause at 52.203-13, as follows:

- “Subcontract” is defined “any contract entered into by a subcontractor to furnish supplies or services for performance of a prime contract or a subcontract.”

- “Subcontractor” is defined “any supplier, distributor, vendor, or firm that furnished supplies or services to or for a prime contractor or another subcontractor.”

- “Agent” is defined as “any individual, including a director, an officer, an employee, or an independent Contractor, authorized to act on behalf of the organization.

The revised rule also defines “Principal” as “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).” This definition also applies for purposes of FAR 2.101, Subpart 3.10 and FAR 52.209-5, Certification Regarding Responsibility Matters.
E. **Regulatory History**

The amendments are accompanied by a lengthy commentary which is likely to be important to interpretation and application of the revised rule. See 73 Fed. Reg. at 67064-67088. The Department of Justice participated extensively in the regulatory process and appears to have had very significant input into the content of the amendments and the commentary. The comments address subjects such as:

- The relationship of revised FAR 52.203-13 to the requirements in the US Sentencing Guidelines (“USSG”) - the commentary maintains that the compliance and ethics program provisions in FAR 52.203-13 are consistent with the USSG (at 67067);

- The rationale for obtaining contractual commitments to disclose violations of federal criminal law and the FCA, which the commentary acknowledges represents a “sea change” and “major departure” from the prior voluntary disclosure regime (at 67069-73);

- The potential impacts of the revised disclosure provisions in FAR 52.203-13 on the relationship between contractors and their employees (at 67072);

- The absence of any risk that the revised disclosure provisions will have the effect of converting private actions by contractors into “state action” when they are conducting internal investigations (at 67072, 67076);

- The interpretation of the “credible evidence” standard and requirement for “timely” disclosure, including a discussion of the relationship between the disclosure provisions in FAR 52.203-1(b) and those under revised FAR 9.406 and 9.407 and pursuant to a contractor’s internal controls system (at 67073-75);

- The requirement that internal controls include monitoring and auditing to detect criminal conduct, and indicating that “[s]tandard business practice … which conforms to generally accepted accounting principles should be sufficient” (at 67068);

- Issues relating to “full cooperation,” including expectations that contractor will provide access to employees and advancement of counsel fees (at 67077-78);

- Interpretation and application of the term “principal” for purposes of determining whether there has been a knowing failure to disclose violations of federal criminal law or the FCA, suggesting that “principals” “could include compliance officers or directors of internal audit, as well as other positions of responsibility” (at 67079);

- The intent and meaning of the obligation to make disclosure of “significant” overpayments and the exceptions for contract financing payments (at 67079);

- The intersection of the new disclosure provisions with the FCA, including its qui tam provisions (at 67080-82);
• Confirmation that the new rule applies to procurement contracts with educational institutions, but not to grants (at 67084):

• Potential implications of the new rule on prime contractor-subcontractor relationships (at 67084).