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REPORT

Ethics

Moves to Include Business Ethics Mandates In FAR Causing Consternation for Contractors

Recent back-to-back moves to incorporate business ethics requirements into the Federal Acquisition Regulation are causing a stir in the contractor community as the deadlines approach for complying with one new set of mandates related to corporate conduct and for suggesting changes to another.

''Confusing,'' ''vague,'' ''onerous,'' ''even ... outrageous'' is how government contract attorneys with the Washington, D.C., law firm Crowell & Moring described clients' reactions to the new rulemakings at a Nov. 29 Webinar hosted by the firm. In their presentations, Angela Styles, a partner in Crowell & Moring's government contracts group, and Dick Bednar, senior counsel in the group, offered their perspectives on how the rules evolved and highlighted provisions in both sets of rules that could prove troublesome to companies doing business with the government.

Under the final business ethics rule that takes effect Dec. 24, federal contractors receiving awards worth more than $5 million and involving work in excess of 120 days will be required to have written codes of business ethics and conduct and to provide those codes to each employee involved in performance of the contract (88 FCR 485, 12/4/07). Under a related proposal, which has a Jan. 14, 2008, deadline for public comments, federal contractors would be required to report to their contracting officers and agency inspectors general if they discover violations of federal criminal law in connection with a contract or subcontract valued at $5 million or more (88 FCR 457, 11/20/07).

The proposed rule on mandatory disclosure of criminal violations was published Nov. 14 and the final business code of ethics rule was published Nov. 23, slightly more than a week later.

Increased Contractor Fraud and Abuse. Styles kicked off the session with her perspective on how the rules came about. Generally, the Justice Department was ''seeing contractor fraud and abuse increase'' and was not seeing industry ''coming together to try to solve the problem,'' said Styles, a former administrator of the Office of Federal Procurement Policy.

More specific contributors to the decision to directly address business ethics in the FAR were the criminal convictions of former Air Force official Darleen Druyun, former Rep. Duke Cunningham (R-Calif.), former OFPP head David Safavian, and discredited lobbyist Jack Abramoff for procurement-related misconduct, Styles said. A poor showing on the part of some contractors involved in the reconstruction of Iraq and the Gulf Coast following Hurricane Katrina, the recent creation of a DOJ procurement fraud task force, and the filing of more than one hundred False Claims Act cases related to the Trade Agreements Act also motivated the rules, she said.

Low Voluntary Disclosure. In addition, both Styles and Bednar emphasized that low contractor participation in a Defense Department program promoting voluntary disclosure of violations of criminal law directly contributed to the proposed rule's move toward mandatory disclosure. According to Styles, there were ''only five voluntary disclosures this year under the DOD program,'' which is run jointly with the Justice Department.

The ''gradual decrease'' in use of the DOD voluntary disclosure program has led to the perception that it is not working, according to Bednar, who is coordinator of a separate, industry-initiated voluntary disclosure program known as the Defense Industry Initiative on Business Ethics and Conduct. The DOD program, which encourages self-policing and voluntary disclosure of DOD contract fraud, at one time was widely accepted and used by defense contractors, said Bednar, who focused his remarks on the proposed rule.

In that rule, the FAR councils cited DOJ's view that ''the requirement for mandatory disclosure is necessary

because few companies have actually responded to the invitation of DOD that they report or voluntarily disclose suspected instances of violations of criminal law relating to the contract or subcontract.''

Proposed Mandatory Disclosure Policy. Bednar asserted that mandatory self-disclosure ''is not good policy,'' either for contractors or the government, and runs counter to the 20-year effort to encourage contractor self-governance, voluntary disclosure, and voluntary cooperation. The legislative basis for mandatory disclosure, he added, lies in legislation (H.R. 3383) introduced by Rep. Michael Castle (R-Del.) last August that includes ''most of the same features'' of the proposed rule (88 FCR 159, 8/14/07).

Bednar suggested that, from the contractor perspective, mandatory self-disclosure encroaches on the constitutional rights and legal protections of employees, destroys the foundation of corporate self-governance, has a poor effect on employee morale, and tends to ''criminalize'' contract administration.

Mandatory disclosure similarly is not in the government's interest, Bednar continued, because it will have a destructive effect on the attorney-client privilege by compelling disclosure and ''so-called'' cooperation, will chill employee willingness to report suspected misconduct internally, and potentially could raise ''state action'' problems for government prosecutors. Concern over these state actions, he added, led DOJ in 1986 to reject a proposal from DOD to make the fraud disclosure program mandatory.

Bednar contrasted the self-disclosure requirement in the proposed rule to the U.S. Sentencing Guidelines, which he said are ''widely regarded as the gold standard for compliance programs.'' The guidelines do not list self disclosure as one of the elements of an effective compliance and ethics program, but include self-reporting to appropriate governmental authorities as a factor in mitigation of culpability for sentencing purposes, said Bednar, who participated in the formulation of the guidelines.

Bednar also took issue with the proposed rule's inclusion of suspension or debarment as a penalty for failure to disclose violations in a timely fashion. ''The government is adamant in describing suspension and debarment as an administrative, protective measure,'' he said. ''This language would be perceived as converting the whole process to a penalty.''

While highlighting faults in the proposed rule, Bednar also advised that the ''sky is not falling.'' There is ''an open door'' for the contracting community to work with DOJ to resolve concerns, he said. He also noted the lack of an ''unqualified warm embrace by the FAR Secretariat'' of DOJ's position in the rule, as evidenced by the rule writers' use of the words ''DOJ requested'' in explaining why the rulemaking was initiated.

As for the Jan. 14 comment deadline, Bednar said an extension is likely, ''particularly with the holidays coming.'' He advised that in commenting on the rule, contractors should ''temper outrage'' and ''attempt to cost compliance with the rule in real dollars.''

He also suggested offering alternatives to the rule. For his part, Bednar recommended that DOD and DOJ give the current voluntary disclosure program ''more visibility'' and make it ''user friendly.'' DOD and DOJ should find out from industry why it is not being used, and more aggressively promote the program, particularly by making ''more explicit'' the expectations ''regarding no company prosecution or company debarment.''

New Business Ethics Requirements. Styles offered a synopsis of the requirements of the final rule on codes of business ethics and flagged areas that may be of particular concern to covered contractors. The new rule, she said, is not applicable to existing contracts and task and delivery orders; ''it is prospective only.'' The rule applies to the ''the entity that signs and executes'' the contract, Styles said.

The $5 million threshold includes ''base plus option years, added together,'' Styles continued. In addition to the monetary threshold, application of the rule is limited to contracts involving work in excess of 120 days.

The rule also includes a ''flowdown'' provision making it applicable to subcontracts valued at $5 million or more. The rule does not require prime contractors to ''judge'' the ethics codes, compliance programs, and internal control systems of their subcontractors, just to check that they exist. However, Styles suggested that the provision could raise some ''legal issues.''

The new rule does not apply to commercial item contracts under FAR Part 12. However, Styles said there is a ''little bit of confusion'' between the rule and the preamble to the rule, which discusses noncommercial contracting under General Services Administration schedules contracting. ''GSA schedule contracts by nature'' are commercial, she said.

Also somewhat confusing, she said, is the preamble's treatment of the rule's exemption for contracts performed entirely overseas. If a contract is performed entirely outside the United States it is exempt. If part is performed in the United States and part is performed outside the country it is not exempt, Styles advised.

Contractors that meet the threshold for coverage under the rule must prepare a code of business ethics within 30 days of award and an internal controls system within 90 days of award unless they ask for an extension, Styles said. She suggested that the additional time may be necessary.

The internal control system required under the rule should facilitate timely discovery of improper conduct and ensure that corrective measures are promptly carried out. The rule says such a system should include periodic reviews, internal reporting, and internal and/or external audits. It does not, however, provide any guidance with respect to ''when one, the other, or both'' types of audit should be used, Styles said.

An exemption from the requirement for a formal training program and internal control system is available to small businesses ''provided you have represented yourself as a small business prior to award,'' Styles said.

Compliance Reviews by COs. With respect to compliance, the rule says contracting officers will incorporate reviews of compliance with the rule into normal contract administration, Styles said. How compliance will be assessed is ''very unclear'' and ''will vary a great deal from contracting officer to contracting officer,'' she added.

Because the ethics code is not a ''deliverable'' for purposes of contract administration, the contracting officer can ask for changes. ''Ask for monetary costs associated with any modifications,'' Styles advised.

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The rule also requires covered contractors to display fraud hotline posters provided by the contracting agency's office of inspector general. However, Styles pointed out that the ''FAR councils have no authority over IG hotline posters.''

The final rule provides an exemption to the fraud poster requirement for companies that have established a mechanism by which employees may report suspected instances of improper conduct and instructions that encourage employees to make such reports.

Most companies that are publicly traded and are covered by the Sarbanes-Oxley Act are likely to already be in compliance with the new rule, according to Styles. Regardless of whether contractors meet the threshold for coverage under the rule, it is ''always good corporate policy to have business ethics'' procedures in place, she said.

''If you do get in trouble, it will help.'' If you don't have an ethics policy, ''it may come back to haunt you,'' Styles warned.

In rejecting arguments for making contractor codes of business ethics, awareness/compliance programs, and internal control systems voluntary, which is the approach taken in Defense FAR Supplement at Subpart 203.70, ''Contractor Standards of Conduct,'' the FAR councils said the ''discretionary rule in the DFARS is no longer strong enough in view of the trend (U.S. Sentencing Guidelines and the Sarbanes-Oxley Act) to increase contractor compliance with ethical rules of conduct.''

The final rule recounts comments from an Army suspension and debarment official who said the majority of small businesses he encountered in reviewing Army misconduct had not implemented contractor compliance programs, ''despite the discretionary nature of the DFARS rule.''

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