

Prepare to Be Tested: Planning Now to Do the Right Thing in a Crisis **the Honorable Eric L. Lipman¹**

I. Introduction: *Emergency Relief in “The Big Easy,” Was Big, But Not So Easy*

When Hurricane Katrina hit Louisiana and Mississippi, the federal government took out its credit cards: For Katrina-related relief, Congress appropriated more than \$132 billion — much of which was later administered through the Department of Homeland Security (“DHS”).²

Yet the mixture of easy credit, a new agency and a large-scale emergency was not always a good one for maintaining sound financial controls. DHS had been established just three years earlier. Thus, when the gale force winds of Katrina began to blow, the Department was still in the process of folding together 22 smaller federal agencies — including the Federal Emergency Management Agency (FEMA), the U.S. Coast Guard and U.S. Customs and Border Protection.

Likewise important, the constellation of DHS component agencies all had their own programs for “streamlined purchasing;” pieces of the Department’s larger Purchase Card, Travel Charge Card and Fleet Charge Card programs. From the outset, DHS agencies used these purchasing methods to accumulate more than \$420 million in charges; a figure that placed the Department among the largest purchase card users in the federal government. During the response to Hurricanes Katrina and Rita, the number and breadth of the Department’s “streamlined purchases” soared. DHS undertook thousands of purchase card transactions to buy goods and services for rescue and relief operations — often times using its special emergency authority for the so-called “micro-purchases” that totaled less than \$250,000.³ In total, during fiscal year 2005, DHS spent nearly \$1 billion through its Purchase Card, Travel Charge Card and Fleet Charge Card Programs.⁴

With the volume of aid that was needed by the storm-damaged areas, the time-pressures on dispensing this assistance and the lack of mature financial systems, it is

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² See, *Oversight of Gulf Coast Hurricane Recovery: A Semiannual Report to Congress*, at 86 (President’s Council on Integrity and Efficiency, August 2008); *Statement of David E. Cooper, Director Acquisition and Sourcing Management*, GAO-06-246T at 3 (United States Government Accountability Office, November 8, 2005).

³ *Control Weaknesses Leave DHS Highly Vulnerable to Fraudulent, Improper, and Abusive Activity*, Statement of Gregory D. Kutz Before the Senate Homeland Security and Governmental Affairs Committee, GAO-06-957T at 1-2 (July 19, 2006).

⁴ *Id.* at 9.

perhaps not surprising that problems resulted. As the U.S. Government Accountability Office (GAO) later summarized to Congress:

Based on our sample of DHS purchase card transactions, we estimated that 45 percent did not have prior written authorization, 8 percent did not provide required sales documentation, 63 percent did not have evidence that the goods or services were actually received, and 53 percent did not give priority to [contracting with “designated sources”].⁵

In one particularly embarrassing tale for the agency, GAO investigators recounted that FEMA purchased 200 laptop computers and 100 printers – many of which could not be later accounted for by agency personnel. Informed that 107 of these laptops, 22 printers and 2 GPS units (together worth approximately \$170,000) had been issued to the FEMA’s Joint Command Post for Katrina relief, GAO investigators traveled to the Command Post’s operations center in the Royal Sonesta Hotel in New Orleans’ French Quarter. Not finding any laptops, printers or GPS devices at the operations center, the investigators included a photograph of an empty conference room in their report to the Senate Homeland Security and Governmental Affairs Committee.⁶

One can presume that the Senators were not amused.

And certainly their anger was not over a few dozen laptops and printers. The federal government spends nearly 50 cents of every discretionary dollar of the federal budget on contracts with private firms – a sum that totals approximately \$425 billion in purchases every single year. Moreover, this trend line is moving upward. The total amounts under contract are nearly double the amounts that were spent in 2000 and the rate of the increases is five times the growth in the Consumer Price Index during the same period.⁷ Adding to this amount, the Administration’s stimulus package has been projected as equaling \$350 billion worth of new purchasing opportunities for private firms. Senators, contracting officers and taxpayers all know the same thing: In this environment, poor financial controls can bring about staggering losses.

Likewise important, notwithstanding very large federal appropriations and spending programs, the size of the compliment of contracting officers has declined in recent years.⁸ Thus, the increase in dollars in the procurement system has meant

⁵ *Id.* at 4.

⁶ *Id.* at 19-21.

⁷ *More Dollars, Less Sense: Worsening Contracting Trends Under the Bush Administration*, at i (U.S. House Committee on Government Reform, June 2007).

⁸ *Historical Federal Workforce Tables*, at 2 (U. S. Office of Personnel Management, 2008); Statement of Brian D. Miller to the Subcommittee on Government Management, Organization and Procurement of the Committee on Oversight and Government Reform, United States House of Representatives, at 3 (April 15, 2008) (hereafter “Statement of Brian D. Miller”) (“The Federal Acquisition Institute’s Annual Report on the Federal Workforce, Fiscal Year 2006, reported 12% fewer contracting officers in Fiscal Year 2006 than in Fiscal Year 1992”).

larger contract portfolios, and more sizeable sets of contract risks, for each contracting officer.⁹ At the most basic, human level, the risk that a particular contracting officer's purchases might be later documented in an unfavorable GAO report – complete with embarrassing photos – is large and growing larger still.

Mindful of the potentially enormous risks to the Treasury, and confidence in government operations, the Office of Federal Procurement Policy (OFPP) instructs, guides and cajoles those who are part of the procurement system. Its instructions to contracting officers who are utilizing the “responsive contracting methods” under the Homeland Security Act of 2002, are particularly apropos. The OFPP guidelines state:

[The] new flexibilities, like existing ones, must be applied in ways that secure cost-effective, quality, and timely results from contractors. Agencies must remain vigilant to avoid practices that focus solely on administrative ease, ignore adequate and necessary oversight, or otherwise fail to effectively consider value to the taxpayer.

....

Because agencies may be faced with having to prepare solicitations for new types of needs within highly compressed timeframes and with limited knowledge, they may find particular benefit in refining requirements during the selection process as their understanding of the marketplace and its capabilities evolves. These refinements may help ensure that the resulting contract reflects the best possible fit between contractor capabilities and agency needs which, in turn, will put the government and the contractor in a better position to manage performance and cost risks.¹⁰

As these Guidelines describe, the contracting officer that is hoping to respond to an emergency with federally-purchased goods and services is thinking about: (a) preparing solicitations within a sharply limited time-frame; (b) overcoming his or her limited knowledge of the marketplace for that good or service; and (c) managing the risks of fraud, abuse and non-performance in this high-pressure contracting environment.

This is why there is more than mere guidance these days. Part of the federal government's response to the rising tide of contract risk has been to revise its regulations. As detailed below, in both 2007 and 2008, the federal government issued far-reaching rules governing the ethical standards of its contracting partners. And by all indications, these reforms have only just begun.

⁹ See, Statement of Brian D. Miller, *supra*, at 3 (“Over the last seven fiscal years, while contracting dollars have doubled, the Federal workforce of contracting officers has not changed. The average contracting officer now supervises twice the volume of contracting dollars as his/her counterpart in Fiscal Year 2000”).

¹⁰ See, *Emergency Procurement Flexibilities a Framework for Responsive Contracting and Guidelines for Using Simplified Acquisition Procedures*, at 7 and 11 (Office of Federal Procurement Policy 2003).

This article will approach the topic of recent changes in government contracting practices with two key premises: (1) compliance with the new monitoring and reporting systems may provide a bidder that is seeking an award under emergency procurement procedures a competitive advantage over bidders who do not have such compliance systems in place; and (2) implementing a well-designed and cost-effective compliance system is a matter that requires careful advance planning – it cannot be done after the emergency has struck.

For contractors who are hoping to position themselves for award in an environment where quick market surveys are performed, a robust ethics compliance program may be the “Good Housekeeping Seal of Approval”¹¹ that is needed to prevail. Demonstrating to procurement officials that an award to one’s firm represents a comparatively low contract risk will be an increasingly important part of the marketing that companies do during the source selection process.

While this kind of “ethics marketing” will be especially important in the context of the “responsive contracting methods” that are used following an emergency, it will also have a role with government contractors of all shapes, sizes and sectors. As the range of business opportunities in the private sector contracts, with the economic downturn, just as the federal government is poised to undertake several hundred billion dollars worth of spending on new projects, many companies will be shifting their focus to public contracting opportunities. Accordingly, for both the contractor that wants to present itself as a low-risk awardee in times of an emergency, and the contractor whose only “emergency” is a sagging bottom line, understanding the new ethics rules is important.

Quite literally, “the rules have changed;” and executives in this market should be thinking deeply about how the government is using the ethics compliance program to manage a growing portfolio of contract risk.

II. Outline of the Key Features of the New Compliance Rules

In parallel sets of federal rulemaking in 2007 and 2008, the Defense Acquisition Regulations Council and the Civilian Agency Acquisition Council (collectively “the Councils”) promulgated new, government-wide rules relating to contractor ethics.¹² These rules strengthen earlier requirements as to codes of business ethics, internal control systems and the dissemination of anti-fraud program information. The provisions of the new rules are detailed in the sections below.

¹¹ For 100 years, *Good Housekeeping* magazine has guaranteed that if any product bearing their seal proved to be defective within two years from the date it was first sold by a retailer, Good Housekeeping would replace the product or refund the purchase price. Among American consumers, the famous warranty is trusted indicia that the product has been tested and will perform as expected.

¹² See, 48 C.F.R. § 1.201–1 (a) (2008) (“revisions to the FAR will be prepared and issued through the coordinated action of two councils, the Defense Acquisition Regulations Council [DAR Council] and the Civilian Agency Acquisition Council [CAA Council]”).

A. The 2007 Rules: The Initial Steps

Throughout most of 2007, and before, the key standards of the Federal Acquisition Regulations on contractor ethics were found in FAR 3.101-1 and 9.104-1. FAR 3.101-1 instructed that government business was to be conducted “in a manner above reproach” and that transactions involving public monies required “the highest degree of public trust and an impeccable standard of conduct.”

Similarly broad language was found in FAR 9.104-1 (d), which provided that prospective contractors must have “a satisfactory record of integrity and business ethics.” And while the absence of information that clearly indicated a prospective contractor was responsible, could render the contractor ineligible for contract award,¹³ what was precisely what was meant by the terms “an impeccable standard of conduct” or “a satisfactory record of performance, integrity, and business ethics” was not altogether clear.¹⁴

Partially filling in these regulatory gaps, on November 23, 2007, the Councils published a final rule that provided some guidance as to what it means to conduct oneself “with the highest degree of integrity and honesty.” The 2007 rule instructed that “Contractors should have a written code of business ethics and conduct.”¹⁵ Additionally, the rule urged contractors to implement 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 of improper conduct in connection with Government contracts; and
- (3) Ensure corrective measures are promptly instituted and carried out.¹⁶

Moreover, with respect to contracts, subcontracts and purchase orders that were in excess of \$5 million, and where the period for performance was more than 120 days, the 2007 rule established two new FAR contract clauses. These clauses, which became effective on December 24, 2007, included additional requirements. The key features of the 2007 clauses are outlined below.

¹³ See, 48 C.F.R. § 9.103 (b) (2007).

¹⁴ See, e.g., *Impresa Costruzioni Geom. Domenico Garufi v. United States*, 238 F.3d 1324, 1335 (Fed. Cir. 2001) (“the regulations concerning responsibility determinations are cryptic”).

¹⁵ See, 72 Federal Register 65873-74 (Nov. 23, 2007) (emphasis added).

¹⁶ *Id.*

1. Contractor Code of Business Ethics and Conduct (FAR 52.203-13)

Under FAR clause 52.203-13, the contractor's Code of Business Ethics and Conduct must be:

- (1) In writing;
- (2) Effective within 30 days of the contract award (unless the contracting officer provides for an implementation date after this period); and,
- (3) Furnished to each employee engaged in performance of the contract.

It is worth noting in this context that the Councils considered, and rejected, the suggestion that the additional requirements be applied on a case-by-case basis. The Councils countered that potentially inconsistent applications of the new requirements would not meet its anti-fraud objectives.¹⁷

2. Fraud Detection and Disclosure Obligations (FAR 52.203-13)

Under the 2007 version of the FAR clause 52.203-13, the contractor agreed to "promote compliance with its code of business ethics and conduct."¹⁸

3. Anti-Fraud Internal Control Systems (FAR 52.203-13)

Unless one of the three enumerated exceptions applied,¹⁹ the 2007 version of FAR Clause 52.203-13 obliged contractors to establish a business ethics awareness program and an internal control system within ninety days of contract award.

The specific elements of these awareness and control programs were not sharply detailed in either the Clause or the accompanying rule. Indeed, the Government declared that procurement officials would not even "judge the internal control system, but only verif[y] its existence...." Similarly, prime contractors were not required to "judge or monitor the ethics awareness program and internal control systems of the subcontractors—just check for existence."²⁰ As the Councils reasoned, the ethics programs were not separate deliverables of these contracts, but rather a set of methods and operations that the Government expected of its business partners.²¹

¹⁷ See, 72 Federal Register 65875-76.

¹⁸ See, 72 Federal Register 65878.

¹⁹ See, 72 Federal Register 65882.

²⁰ *Id.*

²¹ See, 72 Federal Register 65878.

The internal control systems described in the 2007 rule were intended to “facilitate timely discovery of improper conduct in connection with Government contracts” and to “ensure that corrective measures are promptly instituted and carried out.” Among the capabilities the Government hoped the control systems would provide:

- (1) Periodic reviews of company business practices, procedures, policies, and internal controls for compliance with the Contractor’s code of business ethics and conduct and the special requirements of Government contracting;
- (2) An internal reporting mechanism, such as a hotline, by which employees may report suspected instances of improper conduct, and instructions that encourage employees to make such reports;
- (3) Internal and/or external audits, as appropriate; and,
- (4) Disciplinary action for improper conduct.

However, awards to small business concerns (that certified this status in the bidding documents that led to its selection), subcontracts for commercial items, and subcontracts that were performed entirely outside of the United States, were exempted from the requirement to implement such systems.²²

4. Display of Hotline Posters (FAR 52.203-14)

The second of the two new clauses, FAR 52.203-14, requires the Contractor to prominently display hotline posters in the common work areas where contract work is being performed. The posters that must be displayed include:

- (1) any agency fraud hotline poster or Department of Homeland Security (DHS) fraud hotline poster specifically identified in the contract;
- (2) any DHS fraud hotline poster subsequently identified by the Contracting Officer.

In addition, if the Contractor maintained a company website as platform to distribute information to its employees, the new clauses further obliged the contractor to place an electronic version of the required posters on this site.²³

The structure of the clause makes clear that the posting requirements were crafted to operate as part of a larger whole; alongside the Business Ethics and Conduct

²² See, 72 Federal Register 65882.

²³ *Id.*

requirements of FAR Clause 52.302-13. Significantly, as it was with FAR Clause 52.203-13, the posting and website requirements were not applied to subcontracts for \$5,000,000 or less, subcontracts for commercial items, or subcontracts that were performed entirely outside of the United States.²⁴ Moreover, contractors were not obliged to post Government fraud hotline posters designated by the contracting officer if it had its own posters urging the disclosure of improper conduct and a mechanism by which employees could reports of suspected fraud or abuse.²⁵

B. The 2008 Rules: The Requirements Become More Intense

On November 12, 2008, the Councils issued a new final rule revising FAR Clauses 52.302-13 and 52.302-14. The revisions were in part driven by the then-recent enactment of the “Close the Contractor Fraud Loophole Act”²⁶ – a bill whose very name left no doubt as to the tempo of the times on Capitol Hill. The revisions to the 2007 rules are detailed below.

1. Fraud Detection and Disclosure Obligations (FAR 52.203-13)

Under revised FAR Clause 52.203-13, which became effective on December 12, 2008, a contractor that performs under a covered contract agrees to:

- (1) “Exercise due diligence to prevent and detect criminal conduct;”
- (2) “[P]romote an organizational culture that encourages ethical conduct and a commitment to compliance with the law;” and,
- (3) Make timely disclosure to the agency Office of the Inspector General whenever they have “credible evidence” that a principal, employee, agent, or subcontractor has committed a violation of:
 - a. A federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations in Title 18 of the U.S. Code; or
 - b. the civil False Claims Act,“in connection with the award, performance or closeout” of the contract or any of the related subcontracts.
- (4) Implement an internal control system that has the following features and capabilities:

²⁴ *Id.*

²⁵ *See, id.* This crafting of the final rule followed a then-existing DFAR rule and contract clause found at 48 C.F.R. §§ 252.203-7001 (b)(2) and 252.203-7002 (2007).

²⁶ *See*, 122 STAT. 2386-87, P.L. 110–252, Title VI - Accountability and Transparency in Government Contracting, Chapter 1 (June 30, 2008).

- a. Facilitates timely discovery of improper contract-related conduct;
- b. Ensures that any corrective measures are promptly instituted and completed;
- c. Includes adequate corporate authority and resources to ensure effectiveness;
- d. Makes reasonable efforts to exclude individuals who have engaged in illegal or unethical conduct;
- e. Periodically reviews company procedures, policies and internal controls;
- f. Periodically reviews the risk of criminal conduct arising out of contractor operations and methods of reducing this risk;
- g. Hosts a reporting mechanism that offers anonymity – such as a hotline;
- h. Imposes disciplinary action for improper conduct; and,
- i. Ensures “full cooperation” by the contractor’s employees with government “audits, investigations or corrective actions.”²⁷

Among the key differences between the 2008 clause, and the 2007 version that it amended, is that the new clause moves from a “facilitator-promoter” model on business ethics to an “investigator-reviewer” model. Through its regulatory upgrade, the Councils now insist that government contractors pledge resources to search for contract fraud within their own firms, undertake particular abuse prevention functions and make timely disclosures of their findings to specifically-designated agency officials.

The duties of the contractor as anti-fraud “investigator” begin immediately. As soon as the required internal control systems are in place, they will operate over the contractor’s current portfolio of government contracts; and not merely apply to contracts that were awarded after the effective date of the rule. Accordingly, if there were violations of law that occurred before the effective date of the rule – say, an improper set of billing practices under a contract that was awarded in 2006, for example – these violations would be separately reportable to government officials under the disclosure provisions of the internal control system requirements.²⁸

²⁷ See, 73 Federal Register 67091-92 (November 12, 2008).

²⁸ See, 48 C.F.R. § 52.203-13 (c) (2) (ii) (F); 73 Federal Register 67075.

Also important, while the criminal violations that must be disclosed have a specific focus – namely, those involving fraud, conflict of interest, bribery or gratuities – the requirement to disclose violations of the civil False Claims Act is potentially quite broad. Included within the reach of these provisions are “significant overpayments” under existing contracts.

Further, the revised clause places greater pressure on contractors to avoid contracting with, hiring or promoting those who have engaged in unethical or illegal business practices in the past.²⁹

Lastly, in order to comply with Congressional direction in the “Close the Contractor Fraud Loophole Act,” the new rule eliminates the exemption regarding written codes of business ethics and conduct that commercial-item subcontractors had in 2007.³⁰ However, commercial-item and small business contractors are still exempted from the requirements to maintain a business ethics awareness and compliance program and implement an internal control system.³¹

2. Upgrades to the Suspension and Debarment Rules (FAR 9.104-2 and 9.407-2)

As noted above, the 2008 version of FAR Clause 52.203-13 requires contractors and subcontractors to disclose to the relevant agency Office of Inspector General violations of federal criminal law involving fraud, conflict of interest, bribery or gratuities and violations of the civil False Claims Act. At the request of the U.S. Department of Justice, the provisions of Part 9 of the FAR were likewise upgraded so as to render a knowing failure to make these disclosures a cause for suspension or debarment. Further, the revisions to FAR 9.406-2 and 9.407-2 provide specifically that a contractor’s failure to disclose a significant contract overpayment under its existing contracts is likewise a ground for suspension or debarment.³²

These changes have a potentially large and important impact – not because the disclosure requirements are especially burdensome to administer, but rather because they may be a genuine trap for the unwary. Unlike the requirements of FAR Clause 52.203-13, which have certain dollar-level and length of performance thresholds before they are applicable, the provisions of Part 9 apply to a very broad range of federal

²⁹ See, 73 Federal Register 67068 and 67092.

³⁰ See, 122 STAT. 2386-87, P.L. 110-252, § 6102 (“The Federal Acquisition Regulation shall be amended within 180 days after the date of the enactment of this Act pursuant to FAR Case 2007-006 [as published at 72 Fed Reg. 64019, November 14, 2007] or any follow-on FAR case to include provisions that require timely notification by Federal contractors of violations of Federal criminal law or overpayments in connection with the award or performance of covered contracts or subcontracts, including those performed outside the United States and those for commercial items”).

³¹ See, 73 Federal Register 67085, 67091-92.

³² See, 73 Federal Register 67091.

contractors. Accordingly, the mishandling of a discovery by management of “credible evidence” of significant contract-related overpayments, for example, could result in the exclusion of the firm from federal contracting – even though the contractor was a “small business,” or furnishing a commercially available item, or operating wholly outside of the United States.³³

C. Special Practice With Respect to Stimulus Bill Funds:

Arguing that the “unprecedented size and nature of [the] economic recovery package calls for increased oversight and transparency,”³⁴ Senator Claire McCaskill of Michigan amended the “American Recovery and Reinvestment Act of 2009” to add a special set of whistleblower protections for employees of companies that receive funds from the stimulus bill.

The McCaskill Amendment provides a safe-harbor to contractor employees who provide reports of:

- (1) Gross mismanagement of an agency contract or grant relating to stimulus funds;
- (2) Gross waste of stimulus funds;
- (3) A substantial and specific danger to public health or safety related to the implementation or use of stimulus funds;
- (4) An abuse of authority related to the implementation or use of stimulus funds; or
- (5) A violation of a law, rule, or regulation that governs an agency contract or grant related to stimulus funds.³⁵

Under the Amendment, agencies have broad remedial powers to order that any employee who has suffered retaliation for protected disclosures be “made whole.” Such relief may include orders for reinstatement; back pay; compensatory damages; attorneys fees and recovery of litigation costs. And while employees who claim workplace retaliation for their disclosures must seek relief from the contracting agency first, following administrative exhaustion, disclosing employees may proceed to federal court. The federal courts, the Amendment instructs, “shall have jurisdiction over such an action without regard to the amount in controversy.”³⁶ Moreover, the McCaskill

³³ See, 48 C.F.R. § 9.102 (2008).

³⁴ See, Letter of Senator Claire McCaskill to Senate Leadership (January 7, 2009).

³⁵ See, P.L. 111–5, Title XV, Subtitle D, § 1553 (a).

³⁶ See, P.L. 111–5, Title XV, Subtitle D, § 1553 (c) (3).

Amendment adds to the remedies that might already be available to whistle-blowing employees under the False Claims Act or state whistle-blower protection statutes.³⁷

III. Practice Point: The Government Assumes that the New Requirements Simply Codify the Practices of Honest and Prudent Business People

Notwithstanding the fact that the revisions to FAR Parts 9 and 52 establish a detailed set of interlocking anti-fraud mechanisms, to hear some government officials remark on the new provisions, one would be left with the impression that regulators had merely transcribed the most elemental principles of upright conduct and fair dealing. The remarks of Brian D. Miller, Inspector General of the General Services Administration are emblematic of this view. In testimony to the House Subcommittee on Government Management, Organization and Procurement, General Miller observed:

Clearly, all contractors should be required to report fraud involving Federal contracts. Fraud is fraud, and a contractor should not be able to hide behind the complexities of the FAR. Common sense tells us that a good partner with the United States reports crimes. It is part of the public trust that we all share as partners in the procurement process.

First and foremost, American taxpayers need to be protected. If a contractor is aware of a fraud or crime against the United States, it should be that contractor's duty to disclose it to the government. As the Department of Defense Inspector General wrote: "All Government contractors should have an affirmative duty to report potential violations of Federal criminal laws related to Government work especially safety issues."³⁸

In my view, tautologies like "fraud is fraud," or righteous thundering on what "common sense" tells us, simply does not capture the complexities of the revised FAR Clause 52.203-13. The new provisions may well be sensible, but they cannot fairly be described as "common." Does common-sense now oblige every mid-size business to host a fraud hotline?

The righteous tone appears to have its source in an underlying grievance. Many government officials appear to believe that government contractors have broken faith with their "partners in the procurement process," as Inspector General Miller so elegantly put it. And this phrasing is revealing. Inspector General Miller and his colleagues describe federal contractors as "partners" and "team members;" clearly hoping that such affectionate embraces will inspire greater acceptance of the changes. As General Miller explained to Congress:

³⁷ See, P.L. 111-5, Title XV, Subtitle D, § 1553 (f) (1).

³⁸ See, Statement of Brian D. Miller, *supra*, at 6 (emphasis added) (citing Letter from Acting Deputy Inspector General Patricia A. Brannin (January 14, 2008)).

Inspectors General expressed the need for this proposed rule and legislation through the letters they sent to the Regulatory Secretariat in support of the proposed FAR rule in FAR Case 2007-006. The Inspector General of the Department of Interior, Earl Devaney, appealed to the Guiding Principles for the Federal Acquisition System which refers to a “team.” He states: “As team members, our partners in industry must display the same commitment to honesty and integrity in the procurement process as the Federal Government does....” Unfortunately, contractors – our team members – have not been reporting crimes and overpayments. Voluntary disclosures are infrequently used. In Fiscal Year 2007, the DoD Voluntary Disclosure program only had three contractors participate. The simple fact is that the vast majority of crimes involving contractors are not reported. This rule and [the *Close the Contractor Fraud Loophole Act*] would change this problem.³⁹

In my view, those who urged the additional regulations gave short shrift – in public, at least – to contractor claims that the new programs would be demanding to establish, maintain and administer. No one can read FAR Clause 52.203-13 and conclude that the only features sought by the government are “commitments to honesty and integrity in the procurement process.” Were that it was only this simple.

While some of the key difficulties with the new regulations are discussed in greater detail below, at this juncture I merely wanted to underscore the official thinking: Many government officials appear to assume that the new ethics requirements are synonyms for “honesty” and “prudence.”⁴⁰

IV. Practice Point: The Government Assumes that the Detail and Breadth of Regulations that are Familiar in the Securities, Banking and Health Care Industries is a Baseline for Other Industries.

An important backdrop to the upgrades that were developed in the 2008 rulemaking is the view – now widespread in official Washington – that practices which have become familiar in the highly-regulated sectors of securities, banking and health care are appropriate baselines for federal contracting.

As Alice S. Fisher, Assistant Attorney General of the U.S. Department of Justice’s Criminal Division, observed when urging the 2008 regulatory changes:

Our proposal is modeled on existing requirements found in other areas of corporate compliance such as the Sarbanes-Oxley Act of 2002,

³⁹ See, Statement of Brian D. Miller, *supra*, at 2 (emphasis added).

⁴⁰ See, e.g., 73 Federal Register 65874 (the new requirements for a code of business ethics, ethics awareness program and internal control systems capture “the common essence of good ethics and standards of conduct”).

and it expands slightly on the Contractor Standards of Conduct set out by the Department of Defense at DFARS 203.7000. We have been careful not to ask contractors to do anything that is not already expected of their counterparts in other industries, and we have avoided imposing any unnecessary burdens on small businesses or creating any expensive paper work requirement....

[U]nlike healthcare providers or financial institutions, there is at present no general requirement that contractors alert the government immediately as a matter of routine when overpayments or fraud are discovered. We believe that if the FAR were more explicit in requiring such notification, it would serve to emphasize the critical importance of integrity in contracting.

....

As you know, the 1980's witnessed significant innovations in the federal procurement system. Many of those reforms, including corporate compliance programs and corporate self-governance, were adopted with industry cooperation, and were later incorporated into evolving regulatory schemes in other business sectors and industries. In fact, the United States Sentencing Guidelines' treatment of corporations, adopted in 1991, borrowed heavily from reforms that were first instituted for government contractors in 1986. However, since that time, our government's expectations of its contractors has not kept pace with reforms in self-governance in industries such as banking, securities and healthcare.⁴¹

Inspector General Miller sounded similar themes when he testified before Congress the following year. Characterizing the new monitoring, training and disclosure systems as “not unusual,” he expressed surprise and dismay that federal contractors did not more warmly embrace the “minimal, common sense requirements.” He remarked:

The type of reporting requirement proposed is not unusual. In fact, it is much less exacting than reporting requirements for health care providers, who face criminal sanctions for failing to report overpayments. See 42 U.S.C. § 1320a — 7b. The Defense Contract Management Agency put it simply: “I’m surprised that government contractors are not held to the same standard [as health care providers and banking]. With tax dollars at risk, the idea that contractors can profess to have a partnership with the government and then fail to alert us when fraud occurs or overpayments have been made makes no sense....” Unlike other industries, FAR Case 2007-006 imposes only minimal, common sense requirements on Federal government contractors. These requirements

⁴¹ See, Letter of Alice S. Fisher to the Honorable Paul A. Denett, Administrator of the Office of Federal Procurement Policy, at 1-2 (May 27, 2007) (emphasis added); *compare also*, 73 Federal Register 67069-70 (“Our Government’s expectations of its contractors has not kept pace with the reforms in self-governance in industries such as banking, securities and healthcare”).

are more crucial with the rapid growth of government-wide reliance on contractors.⁴²

To my mind, it is open question whether all federal contracts having a dollar value of more than \$5 million and a period for performance of more than 120 days, oblige the same kind of regulatory controls that we insist upon for companies that offer securities for sale to the public or that hold the savings of local depositors. Is it so clear that federal contracts for the construction of an elementary school in Ft. Campbell, Kentucky,⁴³ or the installation of a telecommunications system at a Massachusetts Air Force Base,⁴⁴ or the renovation Forest Service buildings to make them more energy efficient⁴⁵ – to cite a few recently awarded contracts as examples – genuinely need the monitoring, training and disclosure systems set forth in FAR Clause 52.203-13? I am more skeptical.

In the short-term, however, this debate is less important than the insight into official attitudes. The take-away lesson for government contractors is that many in Washington regard the systems that are brought about by the new FAR Clauses as no big deal.

V. Practice Point: The New Rules Represent the Collision of Three Different Models

It also bears mentioning that today's procurement professionals juggle three distinct and competing objectives when administering federal contracting programs. Congress insists that government procurements follow from processes that are:

- (1) Broadly participatory and accessible to qualified contractors;
- (2) Utilizing competition so as to reduce costs to the taxpayer; and,
- (3) Highly transparent, so as to avoid fraud and abuse.

Congress wants the purchasing process to be accessible, competitive and transparent – and it wants these features simultaneously.

What may be less apparent is that each of these requirements relate directly to a critique that will be leveled at Congress, by the voting public, if there are any lapses in oversight. To the extent that government contracting can be characterized as overly-

⁴² See, Statement of Brian D. Miller, *supra*, at 2-3 (emphasis added) (citing Letter from DCMA Acting Director Keith Ernst to the Regulatory Secretariat (January 8, 2008)).

⁴³ See, Contract Award No. W912QR-09-C-0013.

⁴⁴ See, Contract Award No. FA8773-09-D-0003.

⁴⁵ See, Contract Award No. AG-94TZ-D-09-0006.

centralized;⁴⁶ or a game for connected insiders;⁴⁷ or a fount for waste and abuse;⁴⁸ these are political problems for Members of Congress. And so they thunder away on the House and Senate floors, or in oversight hearings, demanding ever-more accessibility, competition and transparency.

⁴⁶ See, e.g., *Statement of the Hon. Eddie Bernice Johnson*, 154 Cong. Rec. E2174 (September 29, 2008) (“[T]he Disadvantaged Business Enterprise, DBE, and the Airport Concessions Disadvantaged Business Enterprise, ACDBE, programs that are vitally important components of the aviation programs we are extending today. These programs are aimed at remedying discrimination to ensure that all American businesses have a fair chance to participate in the business opportunities available at our Nation’s airports.... The bottom line is that, despite the assertions of some critics, the DBE and ACDBE programs remain necessary. [D]iscrimination still makes it impossible for our Nation’s minority and women owned businesses to contribute fully to our national economy”); *Statement of the Hon. Sheila Jackson-Lee*, 153 Cong. Rec. E2306 (November 1, 2007) (“My amendment provides that it is the sense of Congress that the Administrator should ... work toward a goal of awarding to qualified firms located in a county, parish, or other unit of local government within the [hurricane] affected area, but only to the extent that the goal does not interfere with the ability of the Administrator to provide timely and effective assistance.... Mr. Chairman, we have learned from the devastation of Hurricanes Katrina, Rita and Wilma that severe consequences can result from not having the proper disaster recovery plans in place prior to such a disaster. We also know that having in place a comprehensive written response plan to give support to small businesses so that they may rebuild their businesses and in turn help to rebuild the affected areas is an essential component of a good recovery plan. In the aftermath of Hurricanes Katrina, Rita, and Wilma small businesses and in particular minority and disadvantaged businesses, in the affected areas were severely and negatively impacted because they did not receive financial support necessary to rebuild their businesses and participate in the rebuilding of the affected community”); *Statement of the Hon. Corrine Brown*, 153 Cong. Rec. E1076 (May 17, 2007) (“For too long small businesses have been overlooked, short changed and under-funded.... For the past 6 years, the government has failed to meet its 23 percent small business contracting goal. This has cost small business \$10 billion in lost contracting opportunities.... The stability and growth of Florida’s economy depends largely on the vitality of our state’s small businesses who are a diverse group of entrepreneurs and innovators. This large and growing group keeps the Florida economy productive”).

⁴⁷ See, e.g., *Statement of the Hon. Henry Waxman*, 154 Cong. Rec. H4771-72 (May 22, 2008) (“The clean contracting amendment would require agencies to enhance competition in contracting, limit the use of abuse-prone contracts, rebuild the Federal acquisition workforce, strengthen antifraud measures, and increase transparency in Federal contracting.... The egregious procurement practices that have occurred in Iraq and in response to Hurricane Katrina and at the Department of Homeland Security need to be halted. They may enrich companies like Halliburton and Blackwater, but have squandered billions of dollars that belong to the taxpayer.... Full and open competition provides the government with its best guarantee that tax dollars are being spent economically and efficiently”).

⁴⁸ See, e.g., *Statement of the Hon. Louise McIntosh Slaughter*, 154 Cong. Rec. E2110 (September 26, 2008) (“The conflict of interest that results from [the] ‘revolving door’ between private contractors and Government contracting offices can create serious conflicts of interest that may result in an environment of favoritism and profiteering that will only serve to misuse Federal tax dollars and betray the public’s trust.... [The Fairness and Accountability in Defense Contracting Act] will fight the revolving door between Pentagon contracting offices and private defense contractors by strengthening the transparency and reporting requirements for private contractors bidding on and receiving defense contracts. The [Act] will require contractors who are bidding on contracts to disclose any Defense Department employment history of its employees”); *Statement of the Hon. Christopher P. Carney*, 153 Cong. Rec. E616 (March 23, 2007) (“[W]hile private industry as a contracting partner can save taxpayer dollars, I am skeptical that a business that helped to write an RFP and was the only business qualified to receive it really has the taxpayers’ best interests in mind. In fact, this type of malfeasance is criminal, in my opinion.... The financial resources of the Federal Government are limited. It should not be as easy as it currently is to game the system and bilk tens of millions of dollars at a time out the Department of Homeland Security’s budget”).

However, a difficult and rarely-mentioned truth is that a regulatory scheme which boosts transparency in federal contracting – FAR Clause 52.203-13 comes to mind – could likewise undermine progress on achieving Congress’ other goals; like broad accessibility for contractors or obtaining wide ranges of willing bidders. The difficulty for agency personnel and contractors alike is that there has not been a genuine effort to prioritize the various demands. Thus, regulatory upgrades operate as one-way ratchets; with Congress insisting upon progress on all fronts, year after year.

VI. Practice Point: There is a Key Shift that is Occurring and Its Making Its Way to the States

While contractors who work solely with state and local governments may look at the new requirements and simply shake their heads; I argue that they should take a second look at these developments.

The new FAR Clauses did not spring from whole cloth in late 2008. Rather, the current system had its regulatory roots in the provisions of the Defense Federal Acquisition Regulations (DFARS) and spread from there⁴⁹ – first to high-dollar procurements and then to commercial acquisitions and overseas contracts. The next logical step in this progression of regulation would be to state and local contracts.

Some obvious segues to state and local contracting markets from the federal practice would be either through federally-funded emergency relief contracts – where provisions like those found in FAR 52.203-13 could be made a part of the contract – or through special legislation, like the McCaskill Amendment to the stimulus bill, where the receipt of federal monies is expressly conditioned upon acceptance of a new and vigorous ethics compliance regime.

VII. Practice Point: Spend Time Thinking About the (As Yet) Unanswered Questions

For the contractors who think that these compliance systems may be beneficial to their operations, (or, beneficial or not, will be imposed upon them) early planning is recommended. Development of the kind of compliance systems called for under the new FAR Clauses systems involve important business choices. To my mind, the more lead time to plan around these issues, the better.

One particularly vexing issue relates to the maintenance of attorney-client and attorney-work product privileges in the context of the new disclosure rules. As noted

⁴⁹ Compare, 48 C.F.R. § 203.7001 (a) (2007) with 48 C.F.R. § 52.203-13 (2008); see also, Letter of Alice S. Fisher, *supra*, at 2 (“In fact, the United States Sentencing Guidelines’ treatment of corporations, adopted in 1991, borrowed heavily from reforms that were first instituted for government contractors in 1986”).

above, the revisions to both FAR Part 9 and 52 oblige federal contractors to disclose to the Office of Inspector General and the Contracting Officer when they have “reasonable grounds to believe” that a violation of federal criminal law or the civil False Claims Act has occurred. Given the breadth of the triggering statutes, and the complexities in interpreting the requirements of these laws, the “reasonable ground to believe” a violation has occurred may often follow from an attorney’s analysis of particular facts and law. In still other circumstances, there might be pressure to disclose the substance of the advice itself in order to meet the government’s claims that a contractor had a good reason to believe that a covered violation had occurred.

While the drafters of the new rules have specifically disclaimed their intention to oblige contractors to surrender privileged information, or waive rights guaranteed by the Fifth Amendment to the U.S. Constitution, in order to comply with upgraded standards,⁵⁰ it is also true that the regulators have not thoroughly answered the critique that the new rules will operate in just these ways. The rule drafters wrote:

It also is worth pointing out the DoD Voluntary Disclosure Program never required waiver as a condition of participation. Contractors in that program routinely found ways to report wrongdoing without waiving the attorney-client privilege or providing their attorney memoranda reflecting their interviews that normally are covered by the work product doctrine. Any limitation in this rule should not be used as an excuse by a contractor to avoid disclosing facts required by this rule. Facts are never protected by the attorney-client privilege or work product doctrine. Moreover, the Fifth Amendment has no application to corporations, so the only sensitive area is mandatory disclosure or cooperation by individuals or sole proprietors, which is addressed in the clarification.⁵¹

Left only with the assertion that it is “routine” for firms to comply with the new disclosure standards without abandoning applicable privileges, contractors will need to discern their own methods of achieving these results. Developing workable solutions to these problems will, undoubtedly, require time and effort.

Likewise important, and all but unaddressed in the Councils’ response to those who commented on the new rules, is that implementing a robust set of ethical compliance programs may place the earnest contractor at competitive disadvantage when compared to the bidder who has no such systems. In order to make timely disclosures, the new rules appear to oblige systems for:

- (1) compliance training for employees;
- (2) engaging senior officials of the firm to manage the program;

⁵⁰ See, 73 Federal Register 67091.

⁵¹ See, 73 Federal Register 65877; *compare also*, Statement of Brian D. Miller, *supra*, at 2 (“In Fiscal Year 2007, the DoD Voluntary Disclosure program only had three contractors participate”).

- (3) internal reporting of suspected instances of improper conduct;
- (4) collecting and reviewing reports of misconduct;
- (5) undertaking internal investigations;
- (6) making “credible evidence” determinations; and,
- (7) completing periodic reviews of procedures, policies and controls.

Moreover, government regulators have made clear that these systems are not separate deliverables that are purchased by the government⁵² – a declaration that presumably renders any sums spent on developing and managing a compliant program part of the contractor’s general and administrative overhead.

Developing a set of compliance programs that are workable, preserve applicable privileges and are nimbly-priced, will require careful planning.

VIII. Conclusion

Without question, an effective ethics compliance program can yield a number of valuable benefits. Such a program can: educate employees about their duties and responsibilities under the law; prevent workplace misconduct from occurring in the first instance; bolster a company culture of integrity and fair dealing; and signal to the government and other business partners that contracting with your firm represents a low-risk solution. In particular, for the contractor that will be positioning itself for an award under the responsive contracting methods that are used following an emergency, having an ethics program with the new monitoring and reporting systems in place may provide it a competitive advantage over those who do not have such systems.

Yet, these systems take time to build well; so it makes sense to begin thinking about the elements of such a program well in advance of the time that it is needed to operate. Seeing the regulatory changes that are occurring now in federal contracting, state and local contractors have some time that they can use to think about and craft the ethics compliance programs that their firms may need in the future. They have some to prepare before being tested.

⁵² See, 72 Federal Register 65878.