A Brief History of Key Regulations

- 1986 - Packard Commission by President Reagan recommended that defense contractors promulgate and vigilantly enforce codes of ethics and internal controls to monitor compliance
  - 32 major contractors formed the “Defense Industry Initiative on Business Ethics and Conduct”

The original FAR provisions (FAR 3.1002(a)) was “Government contractors must conduct themselves with the “highest degree of integrity and honesty.”

It wasn’t enough.

Big Cases Leading Up to the Recent FAR Change

2004 – One of the largest owner/operators of inpatient rehabilitation facilities in the US agreed to pay $325 million for false claims.

2005 – An investor-owned health care delivery company operating 49 hospitals and 90 outpatient centers and a private teaching hospital were accused of fraudulently inflating patient care cost – combined fine of $1.18 billion

2006 – A major aerospace and defense corporation agreed to pay $615 million to resolve allegations of procurement fraud

2007 – Two manufacturing corporations agreed to pay a combined $17 million fine for sale of faulty body armor to DOD

2008 – A major drug company agreed to pay $362 million to settle a qui tam claim that it failed to provide the government its best price and paid kickbacks to prescribing physicians

Recent Regulatory Changes

Key FAR Revisions Effective Dec, 2008

- FAR 3.10, Contractor Code of Business Ethics and Conduct
- FAR 3.1003, Requirements
- FAR 3.1004, Contract Clauses

Together, these new provisions make the new ethics program clause mandatory for contracts >$5M and more than 120 days duration and make contractors subject to suspension or debarment for knowing failure by a principal to disclose a violation of law or regulation whether or not the contractor is performing contracts containing the clause. They also make contractors responsible for prompt notification if the Government has been overpaid (again, whether or not any contract contains the clause). However, mere disclosure of a violation is not protection from suspension or debarment
The New FAR Ethics Clauses

FAR 52.203-13, Contractor Code of Business Ethics and Conduct (DEC 2008)

The clause requires contractors to have a written code and to make the code available to all employees. It requires contractors to maintain an adequate Internal Control System to prevent, detect and report ethical violations and to require disclosure to the Government of certain violations.

Small businesses are exempt from the clause.

FAR 52.203-14, Display of Hotline Poster(s) (DEC 2007)

This clause requires display of a Government agency Hotline Poster unless the company has its own. It further requires the “flow-down” of the Hotline clause to subcontractors.

No one is exempt from this clause.

Not Required but Good Practice

It is highly recommended that contractors implement a code of ethics and compliance programs even if not required by the FAR. Such a program is a good defensive position against improper practices.

Agencies can (and some have) set lower compliance thresholds and it is the contractor’s responsibility to find out if its customer has set a lower level for compliance.

Contractors should look for clauses from an Agency-specific supplement (DFARS, DEAR, NFS, etc.) or for a “special provision” in contracts or solicitations.

What IS Required for a Small Business?

If contractor is a Small Business as defined by the NAICS code of a particular contract, or if the contract is for a commercial item within the meaning of FAR Part 12, the firm does not have to implement an ethics awareness training program or internal control systems.

Firms “on the cusp” in one or more NAICS codes should consider preparing for compliance prior to requirement. Remember that a firm can be large in one NAICS code and small in another.

The Effect of the Regulations

The effect of the changes to the FAR is to shift the burden to the contractor to institute anti-corruption practices. The Government no longer intends to make any effort to (or even wants to) catch the mistakes. It now expects companies to police themselves and self-report their violations.

Timely reporting is key to compliance. The emphasis has shifted and more is now placed on the actions of individuals.

Responsibility of Individuals

Common Individual Ethics Issues

- Possession of “procurement sensitive” information
• Source selection plans
• Data of competitors

• Gifts and gratuities to “Government officials”
  • Meals & entertainment
  • Holiday gifts
  • Speaking fees

• Campaign contributions
  • By contractors
  • By individuals employed by contractors

• Timekeeping irregularities
  • By individuals
  • By Supervisors or managers

**Procurement Sensitive Info**

Procurement sensitive information is any non-public information concerning a Federal procurement that might give a contractor a competitive advantage. Examples include a source selection plan, an unpublished or advance copy of a solicitation, and proprietary data of another contractor obtained from Government sources, whether directly or indirectly. Such documents will often be marked “For Official Use Only,” “Procurement Sensitive,” “Proprietary Data,” “Proprietary Information,” or “Company Proprietary.” Any kind of Government applied classification (Confidential, Secret, Top Secret) – creates other, much greater, problems.

Individuals are cautioned not to accept procurement sensitive data or information from ANY source. If procurement sensitive information is found in your company, report it immediately to the appropriate company official and turn the information or data over to the official promptly.

**Case Study #1** – In 2008, a major public corporation was suspended and recommended for debarment when a whistleblower alleged that employees of the company had obtained protected source-selection information from an Agency employee and then used it to their advantage in contract negotiations with the agency. The suspension lasted one week, five employees were fired and the company agreed to reimburse the Government for the cost of the investigation. The entire incident resulted from the well-meaning, but misguided actions of a few individuals, but media estimates of the companies lost revenues during that week ranged from $5.7M to as much as $10M per day.

**Case Study #2** – In February, 2012, one office of a major Defense contractor suspended and proposed for debarment when the company disclosed to the Government that its employees possessed, but did not use, proprietary data of a competitor which might have given the company a competitive advantage in a competitive procurement. The suspension was lifted approximately one month later. They entered into a three year agreement with DOD requiring surveillance of their internal controls and extensive employee training, one employee was fired and the company voluntarily withdrew from the competition in question. The entire incident resulted from the misguided actions of a single individual, but it cost the company three years of intense scrutiny and loss of a major contract they were favored to win.
**Gifts and Gratuities**

The Standards of Ethical Conduct for Employees of the Executive Branch sets the maximum permissible value of a “Gift” at $20 (see 5 CFR § 2635.203(b)). Many classes of individuals are prohibited from giving gifts or gratuities to employees of the Executive Branch including all Government contractors and their employees (see 5 CFR § 2635.203(d)).

Federal employees can generally accept unsolicited gifts with a market value of up to $20 per giver, per occasion. There are exemptions for gifts between employees who also have “family relationship or personal friendship.” “Family” is pretty straightforward, but as to “friendship,” just don’t go there.

Even though individual gifts of $20 or less are permitted, the Standards of Conduct prohibit gifts from a single source with an aggregate value in a year that exceeds $50. Federal employees are required to keep track of how much someone (either individual or company) gives them on separate occasions over the year, because the aggregate market value of gift they are permitted to accept cannot exceed $50 annually.

Meals are considered “gifts” if the value exceeds $20 (cost is used as the measure). While eating for less than $20 can be difficult in areas like DC, the rule has no exceptions and an “honor basket” at meetings or receptions is not considered sufficient. There is an exception to the meals rule for Widely Attended Gatherings (WAGs), but the definition of a WAG is ambiguous. Some ethics officers pin it at 25 or more attendees. Others set the number at 100. Still others consider how many different agencies and titles will be represented. If you plan to host a WAG, consider wording in the invitation that interested attendees should check with their ethics officers.

**Campaign Contributions**

General Limitation (11 CFR 115.2) – A Federal contractor may not make, either directly or indirectly, any contribution of money or other thing of value to any political party, committee, or candidate for Federal Office. However, employees of Federal contractors can make contributions from their personal funds.

Corporations, labor organizations, membership organizations, cooperatives and corporations without capital stock may establish, administer, and solicit contributions to a separate segregated fund, referred to as a political action committee (see 11 CFR 115.3).

Limitations on partnerships (11 CFR 115.4) – A Federal contractor that is a partnership cannot use the assets of the Partnership to make contributions or expenditures in connection with a Federal election. However, individual partners can make contributions in their own names from their personal assets.

Limitations on individuals and sole proprietors (11 CFR 115.5) – Federal contractors who are individuals or sole proprietors are prohibited from making contributions or expenditures from their business, personal or other funds under their dominion or control in connection with a Federal election. Their spouses, however, may make donations in their own names.

**Timekeeping**

Employees must charge to the project or activity they work on regardless of the status of the job and they must comply with the company’s timekeeping policies and procedures. Supervisors must provide
employees with a valid charge code for all work and ensure that employees under their supervision comply with all of the company’s timekeeping policies and procedures.

Timekeeping and associated labor law violations are the most common of all ethics issues. In the past year, more than 2,200 firms or individuals were added to the excluded parties list (debarred from Federal contracting) for violations of timekeeping rules on Federal contracts or other labor laws. Most, but not all, were associated with “wage and hour” laws, but some some were associated with failures of timekeeping systems.

The primary agency charged with surveillance of contractor timekeeping systems is the Defense Contract Audit Agency. This agency was created to perform contract audits on all DoD procurement and contract administration activities and to provide uniformity between DoD components. They also perform these functions for many civilian agencies.

DCAA conducts audits in accordance with the Defense Contract Audit Manual (DCAM) and Generally Accepted Government Auditing Standards (GAGAS). Among the audits they perform are:

- Audit of Timekeeping and Labor Systems
- Audit of Internal Controls over those systems
- Floor Checks (timekeeping compliance)
- Compensation Systems Reviews
- Billing Systems Reviews (including tracing labor transactions from TS to voucher)

The most serious timekeeping ethical lapses are those involving diversion of charges or unauthorized changes to contracts. Such actions could result in False Claims Act violation with penalties including fines of up to $10k per occurrence and even criminal penalty for willful violation by an individual. In addition, such a violation could (and probably would) result in finding of a significant deficiency in the contractor’s timekeeping and/or accounting systems.

**Consequences of an Ethical Lapse**

The following is just a partial list of the Federal statutes that may be used to pursue remedies for an ethical violation.

- Forfeiture Statute - 28 U.S.C. § 2514
- Truth in Negotiations Act – 10 U.S.C. §2306
- Mail and Wire Fraud Statutes – 18 U.S.C. §1341 and 1343
- Procurement Integrity Act – 41 U.S.C. §423
- Bid Rigging and Collusive Bidding – 15 U.S.C. §1
Parties at Risk and Potential Consequences

Corporate officers may be at risk if they...

- Certify percentage of completion
- Certify cost and pricing data
- Certify claims
- Oversee compliance programs
- Corporate officers and employees may be at risk if they...
  - Sign contracts
  - Sign payment applications
  - Sign change orders

Consequences of an ethical violation may include...

- Suspension from eligibility for awards
- Debarment from all Federal contracting (including prime, sub and vendor)

In the event of a violation of law, a contractor’s failure to have a program in place will be evidence used to determine punishment-the same standard currently in place for judges to use in sentencing companies found guilty of violating federal law. The Federal Sentencing Guidelines come into play as well as the culpability score. The less evidence that a company has a formal ethics program, the more the courts are instructed to be tough on sentencing.

If a company self-reports, whistle-blowers must be protected (see FAR 52.203-15) and under the Fraud Enforcement and Recovery Act of 2009 (FERA) (see Relief from Retaliatory Actions, 31 U.S.C. 3730(h)), whistleblowers suffering retaliation are entitled to...

- reinstatement with the same seniority status;
- double back-pay;
- any “special damages”; and
- attorneys’ fees.

In addition to fines, suspension, or debarment, the Government could require a “Monitor” to oversee your company’s ethics program. Monitors, when required, are paid for by the Company but approved by the Agency. Monitors operate independently from both the contractor and the government and reports back to the government periodically on the company’s compliance status for a period of 1 to 3 years.