Federal Acquisition Regulation: Mandatory Disclosure Rule Adopted

On December 12, 2008, the "Mandatory Disclosure Rule" (the "Rule") became effective. The Rule amends the Federal Acquisition Regulation ("FAR") and requires government contractors and subcontractors to:

- disclose to the contracting agency's Office of Inspector General ("OIG") known "credible evidence" of a violation of federal criminal law involving "fraud, conflict of interest, bribery or gratuity,"[1]
- disclose to the specific Contracting Officer ("CO") known "credible evidence" of a significant overpayment by the government, and
- within 90 days of contract award develop effective compliance programs and internal controls sufficient to permit discovery of potential fraud and criminal violations.

A failure to comply with the Rule is an independent ground for suspension or debarment from government contracting. The Adopting Release for the Rule states that the purpose of the FAR suspension and debarment policies is not to punish, but to "ensure that the Government does business only with responsible contractors."[2]

The Rule, which resulted from a request on May 23, 2007 to the Office of Federal Procurement Policy by the Department of Justice (the "Department"),[3] has been described as constituting a "sea change" in the relationship between the government and its suppliers. The Department was concerned that the procedures for voluntary disclosure of fraud and other misconduct developed by various agencies were not working and were resulting in too few reports of misconduct and that those received were too abbreviated to be evaluated without undertaking a full investigation. The new Rule requires the contractor to inform the relevant OIG (or in case of an overpayment, the CO) in writing whenever a "principal" (e.g., officer or senior manager) within an organization receives "credible evidence" of a covered violation. The Rule contemplates that, before any disclosure, the organization will satisfy itself that there is a credible basis for a potential violation, but the Rule does not require or invite, but permits, a full independent investigation by the contractor or its outside counsel.

Once it is determined that there is credible evidence of fraud or other applicable misconduct, the contractor must file its disclosure with the OIG on a timely basis. The information submitted must be "sufficient for law enforcement to identify the nature and extent of the offense and the individuals responsible for the conduct."[4] The disclosing party must then fully cooperate with any investigation, including "providing timely and complete responses to Government auditors' and investigators' request for documents and access to employees

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1. 73 Fed. Reg. 67,064 - 90 at 67,065 (Nov. 12, 2008), available at http://edocket.access.gpo.gov/2008/E8-26953.htm (the "Adopting Release").
2. Id. at 67,079.
3. The request was made as part of the implementation of the Close the Contractor Loophole Act, Pub.L. 110-252, Title VI, Chapter 1.
4. FAR 52.203-13(a)(1).

with information."[5] However, a waiver of applicable privileges, such as the attorney client privilege, or rights is expressly not required.[6]

The Rule applies by statute to government contracts amounting to purchases of $5 million or more and lasting longer than 120 days. The mandatory disclosure requirement applies to unlawful conduct relating to any such contract that remains open or for which payment has been made within the last three years.[7] Thus, conduct which the contractor is presently aware of that involves "credible evidence" of a violation must be disclosed, even if it relates back to a time prior to the Rule's effective date, so long as the contract is open or has not been closed for more than three years.

While a failure to comply with the new disclosure requirement provides an independent basis for suspension or debarment of a contractor, the Adopting Release states that "[i]t is unlikely that any contractor would be suspended or debarred absent the determination that a violation had actually occurred."[8] In cases where there is an underlying violation which, if it had been disclosed, would not warrant suspension or debarment by itself, the sanctions under the new Rule could have the most significant application.

The new mandatory disclosure regulation will likely pose substantial challenges to government contractors and subcontractors in determining what constitutes "credible evidence" requiring disclosure of a potential violation, particularly if there is a reasonable factual or legal defense to liability. The issue of how much investigation may be prudently undertaken prior to disclosure to the government will also be troublesome, because the regulations shed no light on what is meant by the obligation to make a "timely" disclosure (although some guidance is set forth in the Adopting Release).[9] Difficult issues could arise if the government were to discover a violation on its own while a lengthy internal investigation by the contractor of the matter was still ongoing.[10]

As explained in the Adopting Release, a disclosure of potential violations pursuant to the Rule, even though mandatory, may remove an organization's exposure to criminal sanctions or to suspension/debarment, but the implicated employee actors will likely face a possible investigation and the risk of prosecution.[11] In general, it will remain to be seen how the FAR's new mandatory disclosure requirement will work in practice, adding a "stick" of possible suspension or debarment for non-disclosure of wrongdoing to the previous "carrot" of a more favorable disposition to reward voluntary self-disclosure.

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5 Id.

6 FAR 52.203-13(a)(2).

7 See FAR 9.406-2 (b)(1)(vi).

8 73 Fed. Reg. at 67,078.

9 Id. at 67,073.

10 The Adopting Release contains some guidance in the form of responses to comments received on the Rule with respect to the regulatory objectives of the new Rule and means of compliance with the Rule, but leaves unanswered a number of questions.

11 Id. at 67,071.

If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Rand McQuinn at 202.862.8932 or mcquiR@cgrdc.com; Kathy S. Strom at 202.862.8944 or stromk@cgrdc.com; Charles A. Gilman at 212.701.3403 or cgilman@cahill.com; Jon Mark at 212.701.3100 or jmark@cahill.com.

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