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General Services Administration
Regulatory Secretariat (VPR)
1800 F Street, NW
Room 4041
Washington, DC 20405

Re: FAR Case 2007-006; Contractor Compliance Program and Integrity Reporting (2nd Proposed Rule) -- Comments of Holland & Knight LLP

I. Introduction

These comments are submitted by Holland & Knight LLP, an international law firm with over 1100 lawyers, which is active in the field of federal government contracts, compliance and ethics programs, investigations and related white collar services. We submit these comments not on behalf of any client, but because we care about legal and policy development concerning federal government contracting. As we describe below, the proposed rule raises substantial concerns that should be addressed by the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council ("Councils").

We believe that federal government contractors and subcontractors, being paid with public money and working to achieve important public goals, have a special responsibility to abide by laws and regulations pertaining to their conduct as contractors. In our experience, the most successful government contractors also have a commitment to ethical behavior and fair treatment of their customers. Nonetheless, we are mindful of the number of cases, some particularly egregious, where unscrupulous contractors have cheated the government. We understand the impulse to address these issues by imposing on federal government contractors mandatory self-reporting obligations regarding conduct that is of particular concern to the government.

Congress, with the enactment of P.L. 110-252 on June 30, 2008, now has weighed in on this subject. Title VI, Chapter I of the legislation is the "Close the Contractor Fraud Loophole Act," which requires in Section 6102 that:

> 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.

Several years ago, the FAR Council amended the FAR to require a contractor to notify the contracting officer of overpayments on a government contract.[1] Otherwise, however, there has not been a general mandatory self-reporting obligation for government contractors.[2] In this FAR case, the Councils propose to impose sweeping new self-reporting requirements on government contractors. Some of these requirements would fulfill the new mandate of the "Close the Contractor Fraud Loophole Act," by obliging contractors to report (1) an overpayment in connection with the award or performance of any government contract or subcontract, and (2) instances in which a contractor has "reasonable grounds to believe" that an employee, agent, or subcontractor has committed a violation of Federal criminal law.

In addition, however, the Councils' proposals would go well beyond the congressional mandate in two regards. First, they would extend a contractor's self-reporting obligation to violations of the civil False Claims Act ("FCA") as well as criminal violations. Second, they would enforce all of the new self-reporting requirements by making a "knowing" failure to timely report such violations or overpayments a cause for suspension or debarment from government contracting.

While the Councils' proposals seem straightforward and have a superficial appeal, we believe that, in practice, they will present contractors with numerous intractable problems and dilemmas, and will ultimately prove counterproductive to the government's interest in promoting honest, efficient, and cost-effective contracting.

II. General Comments

A requirement of mandatory disclosure -- particularly when coupled with the threat of suspension or debarment for "knowing failure to timely disclose" -- will cause a substantial change in the relationship between the contractor and the government, and between the prime contractor and subcontractors. Historically, contractors have not been obliged to self-report violations, or to report violations of subcontractors. The relationship between contractor and the government has involved high levels of trust and cooperation. A mandatory disclosure rule could alter the government-contractor-subcontractor-employee relationship in many ways, some

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[1] FAR 52.232-25(d), [2003]; 52.212-4(i)(5) [2003]; 52.232-26(c) [2003]; 52.232-27(l) [2005].

[2] There has been a specialized reporting obligation for kickbacks in FAR 52.203-7. This derives from a statutory reporting obligation contained in the Anti-Kickback Act. 41 U.S.C. § 57(c)(1)(A). The Act further provides that reporting a kickback to the United States shall be favorable evidence of the contractor's or subcontractor's present responsibility in the case of a suspension or debarment action. 41 U.S.C. § 57(c)(2).

of which are detrimental and some of which are not readily or fully foreseeable. In addition, as discussed below, its practical ramifications will impose significant new burdens on both contractors and the government.

Enforcing these new self-reporting requirements through the threat of suspension or debarment will greatly exacerbate the attendant burdens and risks for government contractors. Suspension or debarment could be an economic "death sentence" for them. If suspension or debarment become the consequence of failing to timely report a violation of criminal law or the FCA, or an overpayment on a contract, that will create an impetus for contractors (1) to rush to judgment in investigating and assessing questionable episodes, and (2) to "over-report" possible violations or overpayments as a precautionary measure even if they doubt that a violation or overpayment actually has occurred. The government will not benefit from receiving rushed reports or from expending its own limited resources investigating disclosures of "misconduct" that is non-existent or marginal at best. As discussed below, the proposed rule will substantially increase the cost of performing government contracts in a variety of ways and will only prove worthwhile if the benefits exceed the costs, a proposition that we doubt and that has not been analyzed by the Councils.

Increasing risk to contractors

The proposed new regulatory regime will cause many government contractors to increase their internal auditing and investigation activities. This increased "self-policing" may help lessen the possibility of fraud or accidental overcharges or mischarges. But it will also be costly and those costs inevitably will be passed along to the government. In addition, to the extent these additional auditing and investigation activities will be beneficial, they will be duplicative of the ethics and compliance program activities already required by the recently adopted FAR Case 2006-007[3] and by the additional compliance and ethics program elements contained in the proposed rule.

From the contractor's perspective, the mandatory reporting obligations in the proposed rule will not only be costly to implement, but also full of potential risks and pitfalls. For example, the results of many internal audits and investigations will not be clear-cut and will require the contractors to make difficult judgments. Whether an "overpayment" occurred often may depend on the interpretation of complicated and arcane accounting issues that could tie up contractors' accountants, attorneys and contract administrators for long stretches of expensive time. Moreover, the requirement for "timely" reporting of all "overpayments" could result in the same level of intense review that is now devoted to a one-time close-out of a cost contract being devoted to each and every payment received on a five-year contract. In fact, in some circumstances, under government cost accounting standards and cost principles and the complexities of cost-reimbursement and "incentive" contracts, it may be impossible to tell whether an overpayment has occurred until the contract is closed out.

In this regard, we note that for decades government agency pricing and payment practices and the FAR clauses that implement them have contemplated routine forms of periodic or close-out adjustments that have never treated "overpayments" as events requiring timely reporting on pain of debarment. Under paragraph "(g)(2)" of the standard "Allowable Cost and Payment"

[3] FAR Case 2006-007, Contractor Code of Business Ethics and Conduct, 72 Fed. Reg. 65873 (November 23, 2007) (the "Code of Ethics Rule").

clause for cost contracts, for example,[4] contracting officers are permitted to audit invoices and vouchers at any time before final payment, and any payment may be adjusted "for prior overpayments or underpayments". This is merely one example of the danger that, absent very careful definition of what constitutes an "overpayment," routine and honest contracting and payment practices may be transformed by the proposed rule into events of suspicion and over-reporting that could erode good contractor-government relationships.

Similarly, determining whether a criminal violation or a violation of the FCA has occurred frequently turns on the knowledge and intent of the persons whose actions are in question, issues that are inherently difficult to assess. An innocent mistake does not constitute a crime or an FCA violation. What are "reasonable grounds to believe" that a violation has occurred, so that disclosure is required? It may be difficult or impossible to define this standard with greater precision, but its vagueness creates uncertainty and risk for contractors who attempt to apply it. This standard is subjective and open to numerous interpretations, particularly in hindsight.

What if the contractor concludes that its employees or subcontractors acted in good faith and that no violation occurred, but a judge or jury later reaches a different conclusion? If the contractor consciously decided not to disclose because it had a reasonable and good faith (but erroneous) belief that there was no violation, would its decision not to disclose be considered a "knowing failure" to disclose? What if a contractor's management concluded, reasonably and in good faith, that no violation had occurred but lower level employees (or the subcontractor) knew better? Is the concept of "collective knowledge" applicable in determining whether a contractor knowingly failed to disclose a violation?[5]

In order to avoid the risk of potential suspension or debarment for a "knowing" failure to disclose, a contractor may decide to report possible violations that it does not believe occurred. But the adverse consequences of making such a "precautionary", or "defensive" disclosure are substantial: it is likely to trigger a lengthy, costly, and debilitating government investigation of the contractor or subcontractor and the relevant employees, and to lower employee morale. The result could be a lengthy investigation of innocent employees or subcontractors, in the course of which security clearances could be jeopardized, personnel could lose their jobs, unions may revolt and subcontractors' responsibility ratings could be damaged. If the entire matter turns out to have been created by misimpressions or a mistaken conclusion about an invoice, will the government indemnify the contractor against suits by employees and subcontractors? Will principles of "privilege" apply under varying state laws to protect the prime contractor for reporting the potential violation or overcharge, especially in situations where the contractor doubted that an actual problem existed and made the report as a precaution? If not, the contractors and subcontractors may need to obtain additional kinds of insurance coverage.

The phenomenon of "defensive disclosures" is very real. The government already has experienced it in connection with the filing of "Suspicious Activity Reports" (SARs") by financial institutions. As a result of regulatory changes and substantially increased enforcement and penalties for failing to file SARs in the years after September 11, 2001, the filing of SARs

[4] FAR 52.216-7 (DEC 2002).
[5] *See U.S. ex rel. Harrison v. Westinghouse Savannah River Co.*, 352 F.3d 908, 918-19 & n. 9 (4th Cir. 2003).

has increased exponentially. A senior government official commented on this phenomenon and identified the cause as follows:

> I suspect that this over compliance is occurring for a reason. It is occurring because financial institutions are – justifiably in my view – unwilling to accept the regulatory or reputational risk associated with an action by the government that would make it appear that the institution is soft on anti-money laundering or, even worse, on terrorists financing.[6]

Essentially the same dynamic would be unleashed here if the proposed rule is adopted. Contractors will be unwilling to accept the regulatory risk associated with a contention by the government that the contractor has knowingly failed to disclose an overcharge or a reportable violation of law.

The Council's proposal to require disclosure of violations of the civil FCA as well as criminal violations exacerbates these problems and imposes additional risks and burdens from the contractor's perspective. It expands significantly the types of situations in which disclosure must be considered. Whereas federal crimes are fairly well-defined, novel and aggressive interpretations of the FCA have created an environment in which many claims of breach of a contract might be construed as FCA violations. (And FCA violations can occur even in situations where there is no financial loss to the government). Furthermore, a criminal violation requires proof beyond a reasonable doubt while a civil FCA violation requires only the preponderance of the evidence. Thus, much weaker evidence arguably might constitute "reasonable grounds to believe" that an FCA violation has occurred than would be the case with a criminal violation.

How much time will the contractor have to conduct an internal investigation and make these difficult judgment calls? The Department of Justice often takes many months or years to investigate whistleblower actions filed under the *qui tam* provisions of the FCA before concluding whether the case has sufficient merit for the Department to intervene.[7] Failure to make a "timely" disclosure to the government renders the contractor potentially liable to suspension or debarment. But the proposed rule does not define what constitutes a "timely" disclosure or provide criteria for assessing this issue. Again, contractors will be left vulnerable to subjective, hindsight evaluations by individual suspension and debarment officials on issues which could mean the financial life or death of the company, its investors, shareholders and employees.

This is not the end of the difficult issues that will confront a contractor under the proposed rule. If a contractor makes a disclosure – either because it concludes that a violation occurred or simply as a precaution to head off any possible issue regarding suspension/debarment -- has it made an admission that could later be used against it in litigation by the government or *qui tam* FCA plaintiffs or shareholders? Conversely, if the contractor seeks to avoid making an admission and files a noncommittal report about a possible violation, has it made the requisite full and candid disclosure?

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[6] Remarks of William J. Fox, Director of the Financial Crimes Enforcement Network, United States Department of the Treasury, October 25, 2004, http://www.fincen.gov/news_room/speech/pdf/20041025.pdf

[7] *See* "A Backlog of Cases Alleging Fraud, Whistleblower Suits Languish At Justice," The Washington Post (July 2, 2008).

If the contractor is a publicly held corporation, additional concerns about potential shareholder litigation and required SEC filings arise. A disclosure may trigger not only a lengthy, costly, and debilitating government investigation, as discussed above, but shareholder litigation as well.[8] On the other hand, a failure to disclose or an arguably untimely disclosure could threaten the company's ability to continue in business and so require disclosure in SEC filings, not to mention shareholder litigation.

Impact of increasing risk to contractors:

The greater the level of ambiguity in interpreting or applying the new requirements, the more difficulty contractors will have in conforming to them, and the greater the potential for unfairness and arbitrariness in decision making by agencies applying the regulations.

In order to address the issues outlined above and to mitigate their risk, contractors will seek the assistance of outside professionals, especially attorneys and accountants. The cost of such professional assistance will be substantial and inevitably it will be passed on to the government in the form of higher prices.[9] Moreover, it is not certain that a contractor's reasonable reliance on the advice of counsel would shield it against a subsequent debarment action.[10]

By coupling new self-reporting requirements with the threat of suspension or debarment, the proposed rule significantly increases the risk of participating in federal government contracting. Companies generally respond to increases in risk by seeking a higher return on investment or by finding some other arena for investment. The proposed rule would likely cause some companies to leave the field or scale back their investment in government contracts and/or to increase their rates of return to reflect the increased risk associated with the new regulatory regime. Again, an increase in the price of federal government contracts and subcontracts would be the likely result.

Impact on the government

Aside from the issue of higher contract costs, the proposed rule will have other, direct impacts on the government. The rule is likely to trigger a significant number of contractor disclosures. It would not be surprising to see Inspector General ("IG") offices flooded with

[8] Often the mere announcement of a government investigation, or the possibility of wrongdoing can have an immediate and deleterious impact on a company's stock price. This often triggers shareholder litigation. The proposed rule will put companies in the untenable position of choosing between making defensive and/or premature reports of potential wrongdoing in order to avoid a suspension or debarment proceeding on the one hand, and triggering a shareholder lawsuit based on investor stock price losses on the other.

[9] We also observe that, particularly with respect to civil FCA violations, many contractors will not have ready in-house command of all the nuances, defenses, distinctions, revisions and latest judicial pronouncements on the FCA. Requiring contractor management and corporate counsel to become experts on the shifting sands of the FCA will entail massive commitments of expensive legal resources. This counsels against institution of a mandatory reporting requirement regarding the FCA that is enforceable upon pain of suspension or debarment.

[10] *See Kisser v. Cisneros*, 14 F.3d 615, 623 (D.C. Cir. 1994) ("The fact that [the contractor] was a participant, and not the ultimate decisionmaker … and that the September decisions were made on the advice of counsel, does not insulate him from sanction.").

hundreds or thousands of disclosures requiring investigation.[11] This will generate a significant increase in investigative activity by the federal government and will require the hiring of more investigators and auditors to investigate the matters that have been disclosed. This investigative process will feed on itself. Once investigations are begun, they frequently take on a life of their own and extend for long periods of time, consuming significant resources in both the public and private sectors.

But it is questionable how many of these disclosures and resulting investigations will involve actual violations of criminal law or the FCA, or significant overpayments. As discussed above, the fear of suspension or debarment is likely to cause contractors to "disclose" anything that comes close to an arguable violation. Thus many, perhaps most, of the disclosures will involve marginal or non-existent misconduct. The expenditure of public and private resources in investigating and resolving such episodes serves little or no useful purpose. Indeed, it is counterproductive, as the government itself has noted in assessing the impact of defensive overreporting of "suspicious transactions" by financial institutions in response to stepped up regulatory enforcement:

> The problem with this sort of filing is that it leads to a dilution of the value of suspicious reporting as a whole. This type of reporting becomes less valuable to law enforcement when the reports document activity or transactions that are not indeed suspicious. It also means we have reports on transactions or activity that have no business rattling around in a government computer. The privacy implications of defensive filings are clear.[12]

Furthermore, the making of a disclosure and the onset of an IG investigation is likely, in many instances, to impair the ability of the contractor and the government contracting officer to resolve efficiently the entire range of normal outstanding issues with respect to ongoing contract performance. Suppose, for example, that the contractor discovers an actual or arguable overpayment. Under current rules, the contractor would simply raise this issue with the contracting officer and request instructions for disposition of the overpayment. "[I]f the contractor provides notification and later determines that it was in error, the contractor can retract the notification as easily and swiftly as it was made."[13]

Under the proposed rule, in contrast, a very different result is likely to occur. Many overpayments might be deemed to evidence a potential violation of the FCA, and FCA violations would have to be reported to the IG, with a copy to the contracting officer. Once a report is made to the IG, the contracting officer is unlikely to resolve the overpayment issue until the IG has completed an investigation. And erroneous notifications made to IGs cannot be easily and swiftly retracted by a contractor.

Or suppose, for another example, that a contractor is developing a new weapon and discovers, after progress payments have been made, that certain technical requirements have not been fully met. If this is construed as a potential FCA violation and triggers a formal disclosure,

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[11] As discussed above, this was the experience of the financial institution oversight and enforcement agencies following stepped up reporting requirements for the filing of SARs in the years after September 11, 2001.

[12] Remarks of William J. Fox, Director of the Financial Crimes Enforcement Network, United States Department of the Treasury, October 25, 2004, http://www.fincen.gov/news_room/speech/pdf/20041025.pdf

[13] 68 Fed. Reg. 56683 (2003).

the resulting IG investigation likely will inhibit a prompt resolution of the underlying contractual problem.

A contractor cannot avoid these difficulties by raising such issues only with the contracting officer and omitting a disclosure to the IG. Under the proposed new regulatory regime, a contracting officer will likely want to know whether any issue that smacks of a possible FCA violation has been disclosed to the IG and, if not, why. Indeed, contracting officers themselves may refer such issues to the IG as a precaution.

Further, the making of a disclosure may well impair the ability to administer an ongoing contract with respect to other, unrelated issues. Contracting officers and a contractor's own employees often act much more cautiously and slowly when they believe that their contract is already "under the microscope." Thus, regular contract performance and close-out will likely be interrupted and delayed in numerous instances. The routine adjustment and settlement of mistaken overpayments, innocent but erroneous contractor billings, and unallowable cost matters will become extremely difficult to accomplish.

Is the Proposed Rule Worthwhile?

It is evident that the proposed rule will entail significant costs to contractors and to the government itself, both direct and indirect. Some portion of these costs may be absorbed by contractors but the great majority ultimately will be borne by the government in the form of higher contract costs and an expanded investigative bureaucracy. The question is whether the benefits of the proposed rule will outweigh these costs.

There is substantial reason to think that the proposed rule will not be cost effective and will ultimately prove counterproductive to the government's interest in promoting honest, efficient, and cost-effective contracting. The unexamined assumption underlying the proposed rule is that government contractors currently are engaging in a considerable amount of fraud and overcharging that is not being detected and deterred by existing laws and regulations. We doubt that this is so. In fact, government contractors already are subjected to much closer scrutiny than contractors in the private sector. Their books and records are examined regularly by the DCAA and the various IGs. They are subject to investigation by the IGs and by numerous federal investigative agencies, including the FBI and DCIS. And the 1986 amendments to the FCA have created enormous incentives for private parties (including contractor employees) to disclose to the government any fraud or suspected fraud in connection with a government contract. The federal courts are flooded with such whistleblower suits under the FCA, and the Department of Justice ("DOJ") cannot keep pace with the backlog of these suits awaiting investigation.

Government contractors already have strong incentives to disclose to the government any actual criminal or FCA violations of which they become aware. Under the federal Sentencing Guidelines, a contractor's punishment for criminal misconduct will be reduced significantly if it makes a voluntary disclosure and cooperates with the government.[14] Likewise, under the present

[14] In fact, if a contractor has in place the kinds of compliance and ethics program procedures required by the proposed rule, it is unlikely that criminal charges would be brought in the first place. It is current Department of Justice policy, outlined in a memorandum by former Deputy Attorney General Paul McNulty, that federal prosecutors must examine whether or not a company under investigation has in place an effective compliance and ethics program as part of the decision whether or not to bring criminal charges. *See* Memorandum from Paul J.

version of the FCA a contractor can limit its vulnerability to a potential whistleblower suit by making a public disclosure of an issue to the government.

Under the current system, these incentives for disclosure are linked to the strength of the evidence and the amount of money at stake. There is more incentive to disclose clear-cut violations than marginal or merely arguable ones. And there is more incentive to disclose issues involving significant loss to the government than issues where the loss is minimal or insignificant. This, we submit, is as it should be. This system serves to limit the expenditure of resources by the contractor and the government to those cases most deserving of that expenditure. In contrast, a principal vice of the proposed rule is that it creates incentives for contractors to disclose marginal or arguable issues which then will end up consuming disproportionate amounts of investigative resources that they do not merit.

Of course, no legal regime, including the proposed rule, will ensure that all contractors police themselves and dutifully (and timely) report all instances in which they have reason to believe that misconduct has occurred. There will always be some contractors who will gamble that they will not get caught if they do not make a required disclosure. Or the magnitude of the misconduct may be such that a contractor concludes that disclosure will inevitably lead to debarment (and/or imprisonment for its owners or officers), so that it will take its chances on getting caught. The proposed rule creates the threat of suspension or debarment if a contractor knowingly fails to make a disclosure. But this threat is effective only if a contractor believes that it can make the disclosure and survive the consequences, whereas failure to disclose will imperil its ability to perform government contracting. This result will occur most often in cases involving relatively minor or marginal misconduct.

In sum, even though the essential purpose of the proposed rule is to protect the public fisc, there appears not to have been any cost-benefit analysis of whether it will cost taxpayers more (and perhaps much more) than would be saved. We submit that such a cost-benefit analysis should be conducted before a decision is made to adopt the proposed regulation. Indeed, we believe that a cost-benefit analysis is required.

Additional Issues Related to Use of Suspension and Debarment as an Enforcement Mechanism for Disclosure

The proposed rule's reliance on suspension and debarment as the enforcement mechanism for mandatory disclosure exacerbates the infirmities in the existing regulatory regime for imposing those sanctions. Under this regime, a contractor has only limited due process rights. For example, the Administrative Procedure Act ("APA") prohibits agency staff from combining prosecutorial and adjudicative functions in the same case, and requires that administrative adjudications be conducted by an administrative law judge. But these procedural protections do not apply to suspension or debarment proceedings.[15] Instead, those proceedings are resolved through an informal administrative process before an agency "debarring official" who need not be a lawyer.

McNulty, Deputy Attorney General, to Heads of Department Components, United States Attorneys (December 12, 2006).

[15] *Girard v. Klopfenstein*, 930 F.2d 738, 741-43 (9th Cir. 1991.

There are two basic defenses that a contractor may raise to a proposed debarment or suspension. The first is that there is no cause for debarment (or suspension), *i.e.* that the alleged basis for debarment did not occur. The second is that, notwithstanding that cause for debarment exists, it is outweighed by other factors that establish that the contractor is "presently responsible." A contractor is entitled to an informal evidentiary hearing before the agency debarring official on the first issue only if it can demonstrate a genuine dispute over material facts. And a contractor has no right to an evidentiary hearing on the latter issue of whether it is "presently responsible".

Further, a contractor's only right of appeal is to file suit in a federal court pursuant to the APA and attempt to demonstrate that the agency's debarment (or suspension) decision was arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.[16] This highly deferential standard of review presumes the validity of the agency decision and permits reversal only if the decision is not supported by substantial evidence, which can be satisfied by something less than the preponderance of the evidence.

These limited due process rights are seldom an issue under the current framework for suspension and debarment because of the way that it works in practice. In general, there are two categories of causes for debarment or suspension. The first category involves a conviction of a criminal offense or a civil judgment for fraud in connection with a public contract or subcontract. The great majority of debarments fall into this category, where the existence of cause for debarment already has been established by prior judicial proceedings. Thus the only real issue is whether the contractor can establish that there are sufficient mitigating circumstances that it is nonetheless now a responsible contractor. This is the sort of discretionary judgment call that is often delegated to an administrative agency. The agency is deemed the best judge of those with whom it is prepared to do business despite a blemished record.

Decisions regarding suspension for this sort of misconduct sometimes must be made before there is a judicial determination of whether the misconduct occurred, *i.e.* while the matter is pending in court. But, in practice, suspensions normally occur only in situations where a contractor has been indicted for a federal crime (which is established by regulation as a cause for suspension).[17]

The second category of debarment/suspension involves cases where the agency itself must establish the existence of cause for debarment, *i.e.* that the alleged misconduct occurred, as part of the administrative process. These are the cases where the limited due process rights offered to a contractor can become a very significant issue. But, in practice, agencies seldom pursue such debarments or suspensions, where they must "start from scratch" instead of relying on a prior adjudication to establish the existence of cause for debarment.

The proposed rule would create new causes for debarment (or suspension) – failure to timely disclose a violation of federal criminal law or the FCA or an overpayment – that fall squarely in this second category of cases. The practical ramifications of this are very troubling. Suppose, for example, that a contractor is convicted of a federal crime or adjudicated to have violated the FCA. If the contractor had not timely reported that violation to the relevant agency,

[16] 5 U.S.C. § 706(2).
[17] FAR 9-407-2(b).

then it could be debarred under the new provision established by the proposed rule. But there would be no need to resort to this provision. It would be far simpler to debar the contractor under the existing regulations based on the conviction or the FCA adjudication. The new regulation would have practical importance only in situations where a contractor's culpability had not been already been adjudicated. It would only be invoked where an agency decided unilaterally to sanction a contractor by "proving" through an informal debarment or suspension adjudication, with no judge or jury and where the rules of evidence are not applicable, (1) that the contractor or one of its subcontractors had committed the violation, and (2) that the contractor knowingly failed to disclose it.

The proposed rule raises additional concerns by making a contractor's failure to timely disclose any overpayment cause for suspension or debarment, with no minimum threshold. The other causes for suspension and debarment all involve significant misconduct by a contractor, not petty violations. When the requirement for a contractor to notify the government of overpayments on commercial-item contracts was originally imposed in 2003, the Councils rejected the suggestion that a minimum threshold should be imposed, reasoning that "[n]otification helps to reinforce the public's trust that taxpayer dollars are being properly expended and is important, even for smaller dollar transactions, because there may be a mistake in the payment process that will cause future payment errors."[18] This reasoning may be valid when all that is being imposed is a contractual reporting duty, but it is not a valid reason for exposing a contractor to the threat of suspension or debarment.

One of the ironies of the proposed rule is that, whereas in an actual FCA suit involving perhaps twenty million dollars, a contractor may interpose a variety of defenses and enjoy the right to a jury trial, by contrast if that contractor were regarded by an agency as having failed to "timely" disclose an "overpayment" of perhaps only one hundred dollars, the contractor could be debarred without judge or jury and irrespective of the tiny amount at issue.

We respectfully suggest that if the government is going to rely on suspension and debarment to enforce the disclosure requirements, the process for imposing those sanction should be changed. One suggestion to improve the fairness, predictability and procedural regularity of the debarment system would be to involve the Civilian Board of Contract Appeals and the Armed Services Board of Contract Appeals (collectively "Boards"). The Boards could either act on recommendations of an agency debarment official or review de novo a decision of an agency, and could stay such decision pending review.

Proposed Amendments to the False Claims Act

The proposal to require disclosure of violations of the FCA should also be considered in light of potential amendments to that Act now under consideration by Congress. In particular, the interplay between the *qui tam* provisions of the FCA, including the "public disclosure" bar, and the new requirement for contractor self-reporting need to be carefully assessed.

Currently, the FCA provides significant incentives to private whistleblowers to file *qui tam* suits on behalf of the federal government when they have independent knowledge of a fraud.

[18] 68 Fed. Reg. 56683 (2003).

But the "public disclosure" provision bars parasitic *qui tam* suits based on publicly available information unless the relator is an original source of this information.

From a public policy perspective, a *qui tam* provision to encourage private parties to report fraud in connection with government contracts may be redundant if contractors, themselves, now are under a mandatory duty to report such misconduct. There is a substantial argument that government contracts subject to the new mandatory disclosure rule should be exempted from *qui tam* suits.

In any event, the government should not want *qui tam* relators to share in the recoveries resulting from FCA cases involving matters that were disclosed by the contractor. In such situations, the relator has performed no public service that merits reward; he or she is simply siphoning off a portion of funds that should go to the government.

Under the current FCA, a contractor faced with a parasitic *qui tam* suit can invoke the public disclosure bar and seek dismissal of the suit because it is based on information that already has been publicly disclosed.[19] This may change as a result of the amendments to the FCA presently under consideration. These amendments may create a situation where *qui tam* relators could unfairly benefit from new mandatory disclosure requirements to the detriment of both the Government and the contractor.

Under S. 2041, as reported out by the Senate Judiciary Committee in April, 2008, government employees may become *qui tam* relators in certain circumstances, and there is no blanket exclusion of IG employees, contracting officers or those working with contracting officers. Furthermore, S. 2041 would also remove the right of a defendant to seek dismissal on the ground that the relator's suit was based on publicly disclosed information. Instead, S. 2041 would permit (but not require) the DOJ to seek dismissal of a *qui tam* action if the allegations relating to <u>all</u> essential elements of liability are based <u>exclusively</u> on publicly disclosed information. Alternatively, the DOJ could seek to dismiss a relator from an FCA action if the relator is a federal government employee who learned the information that underlies the alleged violation in the course of his or her employment and certain other requirements are met.

The confluence of this pending legislation and the proposed FAR regulatory changes should counsel great caution. We submit that it furnishes an additional reason for excluding from the proposed rule, at least for the time being, a requirement for contractors to report violations of the FCA upon pain of suspension or debarment.

III. Technical points

If the proposed rule is to be adopted, at a minimum we suggest the following technical changes to it.

1. It is proposed that FAR 52.203-13 be amended to require the contractor to make a disclosure "whenever the Contractor has reasonable grounds to believe that a principal employee, agent, or subcontractor of the Contractor has committed a violation of the Civil False Claims Act or a violation of Federal criminal law in connection with the award or performance of this

[19] 31 U.S.C. 3730(e)(4).

contract or any subcontract thereunder." It is not entirely clear whether the limiting clause "in connection with the award or performance of this contract or any subcontract thereunder" applies to reporting both violations of Federal criminal law and violations of the FCA. We believe that this is the better reading of the provision, as well as its intent. We suggest that the provision should be clarified by re-wording it to say: "whenever, in connection with the award or performance of this contract or any subcontract thereunder, the Contractor has reasonable grounds to believe that a principal employee, agent, or subcontractor of the Contractor has committed a violation of the Civil False Claims Act or a violation of Federal criminal law."

2. The causes for debarment and suspension in Part 9 of the FAR would be enlarged to include "Knowing failure to timely disclose…"(a)n overpayment on a Government contract"; a (v)iolation of the civil False Claims Act…in connection with the award or performance of any Government contract" and a "(v)iolation of Federal criminal law in connection with the award or performance of any Government contract or subcontract." We submit that the proposed amendments to FAR Part 9, concerning causes for suspension and debarment, should be clarified to link a contractor's "knowing failure to timely disclose" to the breach of a contract clause imposing the requirement to disclose. Otherwise, the reference to "any Government contract or subcontract" arguably could be applied even where there is no mandatory reporting requirement imposed by a contract clause. The Part 9 regulations would arguably impose a general obligation on government contractors to report any and all violations of federal criminal law or the FCA of which they are aware. The legitimacy of such a reporting obligation, that is not based on a consensual contract provision, is open to serious question.

3. The proposed amendments to FAR Part 9 do not define "knowing" or "timely" as used in the key phrase: "knowing failure to timely disclose." Since the suspension and debarment regulations are enforced separately by each agency, the absence of clear definitions is especially problematic. We submit that the definition of "knowing" should be clarified to mean actual knowledge that, in the case of a corporation, is possessed either by a supervisor or an authorized agent.[20] Likewise, we submit that the requirement of "timely" disclosure should be modified to provide that it addresses a knowing failure to timely disclose after a reasonable period for investigation.

IV. Alternative Approach:

There is an alternative to the proposed rule that would create better incentives for contractors both to abide by the law and the various requirements imposed on contractors, and to disclose – but not over-report -- violations of law. The Government, in awarding contracts, could create an evaluation factor that measures the attributes that it is trying to foster: an effective compliance plan, a culture of honesty, reporting to the Government when violations occur, a high degree of responsibility, and a reputation for integrity. If the Government evaluated contractors in these areas, competition would create an enormous incentive for contractors to act as the government desires, but this incentive would be created in a way that encouraged trust and cooperation between the government and the contractor.

There already exist substantial incentives for government contractors to implement rigorous and effective compliance and ethics programs. These include: (1) highly publicized

[20] *See United States v. Ladish Malting Co.*, 137 F.3d 484, 493 (7th Cir. 1998).

civil and criminal enforcement actions in the government contracts and health care industries; (2) the imposition of mandatory compliance programs as part of settlements in fraud cases involving government programs, many with expensive court appointed independent monitors;[21] (3) judicial rulings that boards and managers of companies in heavily regulated industries who do not implement compliance and ethics programs may violate their fiduciary duties;[22] (4) enactment of the Sarbanes Oxley Act, the USAPATRIOT Act, the Deficit Reduction Act and other legislation which mandates a variety of compliance and ethics procedures; (5) recommendations by various agency Offices of Inspectors General; (6) the guidance of the United States Sentencing Commission on effective compliance and ethics programs;[23] (7) the enforcement policies of the Department of Justice as currently set forth in the McNulty Memorandum; and (8) the Councils' own actions in the proposed rule and in the final rule resulting from FAR Case 2006-007. The confluence of these and other developments has resulted in a situation where most significant companies which do business with the government either have, or soon will have compliance and ethics programs. There is also a growing body of data that demonstrates that companies with strong compliance and governance programs are better run and do better financially than companies without these attributes.[24]

Making an assessment of the compliance and ethics programs of offerors as a part of evaluating their proposals would build upon and knit together all of the foregoing developments. It would provide a powerful additional incentive for government contractors to adopt and enforce "best practices" with respect to their compliance and ethics programs.

Among the criteria of a good compliance and ethics program is a commitment to appropriate reporting of overpayments and improper conduct. Good companies know that fair and ethical treatment of their customers is one way to keep them coming back. Companies with good compliance and ethics programs will train their employees to treat their government customers fairly and to comply in good faith with applicable contractual and regulatory requirements. They will monitor performance and regularly audit compliance. They will investigate irregularities in contract performance. They will report overpayments and repay money they are not entitled to keep. They will report violations of law by their employees and voluntarily take corrective actions. In sum, they will do the things the Councils want them to do.

Significantly, however, the motivation for these behaviors will not be fear of losing the ability to do business with the government. Fear is not the best motivator for responsible contractor behavior. Rather, the motivation will come from a culture of compliance – do the right thing for its own sake – and because it ultimately gives a contractor a competitive advantage. In contrast, the proposed rule, for the reasons set forth herein, will not only fail to accomplish its goals, it will trigger an array of unintended and counter-productive consequences.

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[21] "Scrutiny of Corporate Monitors Is on the Rise," Christopher J. Gunther and Robert M. Pollak, The National Law Journal (March 31, 2008).

[22] *See In re Caremark International, Inc. Derivative Litigation*, 698 A. 2d 959 (Del. 1996); *Stone v. Ritter*; 911 A. 2d 362 (Del. 2006); and *Miller v. McDonald, et al. (In re World Health Alternatives, Inc.,* Bankr. Case No. 06-10166, Adv. Pro. No. 07-51350 (Bankr. D. Del. April 9, 2008).

[23] United States Sentencing Commission, Guidelines Manual, §8B2 (Nov. 2006).

[24] *See Corporate Governance and Equity Prices,* Paul Gompers, Joy Ishii, and Andrew Metrick, The Quarterly Journal of Economics, February 2003; *Corporate Governance and the Cost of Equity Capital*, Hollis Ashbaugh, University of Wisconsin, Daniel Collins, University of Iowa, Ryan LaFond, University of Wisconsin (December 2004); and benchmarking studies by Governance Metrics International.

We urge the Councils to delete mandatory reporting provisions that exceed the mandate of the "Close the Contractor Fraud Loophole Act." We also urge the Councils not to utilize suspension and debarment as the mechanism to enforce the new disclosure requirements. At a minimum, we urge the Councils to delay any action beyond the steps required by the "Close the Contractor Fraud Loophole Act" until a cost-benefit analysis is conducted and until the potential amendments to the FCA presently pending before Congress have been acted upon.

Holland & Knight appreciates being given this opportunity to submit our comments. If you have questions or need additional information, please feel free to contact any of us.

Respectfully Submitted,

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