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Construction Law Report

Ethics and Disclosure Requirements for Federal Contracts

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Introduction

As the commercial construction industry continues to struggle, an increasing number of contractors have been turning to the federal government as an important source of work. However, as experienced government contractors are aware, the rules associated with federal government contracts are significantly different than those applicable to private, and even state-funded, construction projects. The complexity of performing many federal government construction contracts has increased in recent years with the passage and implementation of the American Reinvestment and Recovery Act (ARRA), and other federal laws and programs providing funding for new government projects. Although the additional allocation of funds for federal construction projects has been welcomed by the industry, the government has increased its oversight of those projects in several ways, including creating new requirements relating to contractor business ethics and mandatory disclosure of certain prohibited conduct.

Prior to December 2007, many federal government contractors voluntarily developed and adopted a code of business ethics, including procedures for disclosure of improper conduct. Contractors voluntarily adopted such codes for several reasons, including (a) the Department of Defense and other federal agencies stated that contractors should have such codes, (b) in debarment and suspension decisions, officials may consider whether a contractor had effective standards and control systems in place, (c) in criminal investigations, prosecutors may consider the existence and nature of compliance programs and proceedings, and (d) having such a code and compliance program in place may be relevant in sentencing decisions.

Because the government had become dissatisfied with voluntary nature of the disclosure process, in December 2007, the Federal Acquisition Regulation (FAR) Council published new requirements for most government contractors to develop and to adopt a code of business ethics and conduct. A year later, in December 2008, the FAR Council published another final rule that added mandatory requirements for disclosure of violations of criminal laws, civil False Claims Acts, and significant overpayments by the Government.

Although these requirements have now been in place for a few years, seasoned government contractors should remain focused on compliance issues such as those discussed in this article, and contractors new to federal government contracting should carefully consider these issues in planning and performing their work. To assist in that effort, we have included below a summary of these revised federal compliance requirements, as well as certain guidance that the Defense Contract Audit Agency (DCAA) has issued for its auditors in conducting reviews of contractors' compliance efforts.

FAR Compliance Policy

As an initial matter, the FAR regulations contain certain policy guidance that applies to all contractors, regardless of size. First, the FAR requires that all government contractors conduct themselves with the highest degree of integrity and honesty. Second, the FAR provides that all contractors should have a written code of business ethics and conduct.

To promote business ethics and conduct compliance, all contractors should have 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 and disclosure of improper conduct in connection with government contracts; and
- (3) Ensure corrective measures are promptly instituted and carried out.

Note that these initial policy objectives are applicable to all contractors, but do not require mandatory codes of business conduct and compliance and training systems on all contracts. As discussed below, the mandatory requirements for such codes and systems apply only to contracts exceeding dollar and schedule thresholds.

FAR Compliance Regulations

The FAR instructs the contracting officer to insert the clause at FAR 52.203-13, (Contractor Code of Business Ethics and Conduct) in solicitations and contracts if the value of the contract is expected to exceed \$5,000,000 and the performance

Construction Practice Recent Accolades

There are a select few directory-style publications that provide information ranking law firms and lawyers whose endorsements are coveted because their research involves approaching users of legal services directly and independently to discuss law firms and lawyers with whom they have dealt. We are proud to report that Seyfarth Shaw's Construction Practice was recently recognized by several of the most prestigious of these publications:

Chambers & Partners 2011: Chambers & Partners is a UK-based publisher of guides to the legal profession, identifying and ranking the world's best law firms and lawyers through a combination of client interviews, lawyer interviews, law firm submissions and their own database resources. Chambers' 2011 USA guide recognized Seyfarth's Construction practice with a prestigious national ranking for the practice as a whole. In addition, the team was pleased to have achieved two special national designations: "Recommended for Client Service" and "Recommended for Commercial Awareness." Regionally, the Construction practice received rankings in Washington, D.C. and Georgia, and several individual attorneys were ranked as well, including Chip Ingraham in Atlanta; Michael McKeeman in California; and Bennett Greenberg, David Mancini and Kim Preston in Washington, D.C.

Our Construction group also was nominated by Chambers in the Construction team category for their esteemed 2011 Chambers USA Awards for Excellence. These awards reflect a law firm's national pre-eminence in key practice areas. They also reflect notable achievements over the past 12 months including outstanding work, impressive strategic growth, and excellence in client service.

Legal 500 2011: Similar to Chambers & Partners, the Legal 500 series also provides worldwide rankings of legal service providers. The 2011 edition of The Legal 500 US ranked our Construction practice again this year in the national category covering both construction and construction litigation. According to clients, the attorneys in the firm's Construction practice provide "tactically sound advice" and "quickly come up to speed on all local rules and issues," when working in unfamiliar jurisdictions. Notably, Bennett Greenberg in Washington, D.C. was recognized in Legal 500's elite "leading lawyers" list. Kim Preston and Steven Kmiecik in Washington, D.C., Michael McKeeman in California, and Leah Rochwarg in Boston were also recommended in the construction and construction litigation editorial.

PLC Which Lawyer? 2011: The Practical Law Company's "PLC Which Lawyer?" guide also recognized Seyfarth Shaw's Construction practice in their annual recommendations. We are pleased to have been "Highly Recommended" in the U.S. for our national construction team, as well as regionally in Washington, D.C. The group was also ranked regionally in Illinois. Construction Partners Kim Preston in Washington, D.C. and John Anderson in Chicago both received individual endorsements.

period is 120 days or more. It is important to note, however, that whether or not clause 52.203-13 (discussed more fully below) is applicable, a contractor may be suspended and/or debarred for knowing failure by a principal to timely disclose to the government, in connection with the award, performance, or closeout of a government contract performed by the contractor or a subcontract awarded thereunder, credible evidence of a violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code or a violation of the civil False Claims Act. Knowing failure to timely disclose credible evidence of any of the above violations remains a cause for suspension and/or debarment until three years after final payment on a contract.

Importantly, the terms “timely disclose” and “credible evidence” are not defined by the FAR. Therefore, contractors are required to use their judgment with respect to both (a) whether the information available amounts to “credible evidence” of a violation, and (b) if so, when such information must be disclosed.

FAR Clause 52.203-13 Code of Business Ethics and Conduct

Code of Business Ethics and Conduct

If the value of the contract is expected to exceed \$5,000,000 and the performance period is 120 days or more, FAR 52.203-13 requires that a contractor prepare and implement a written code of business ethics and conduct. Specifically, within 30 days after contract award, unless the contracting officer establishes a longer time period, the FAR provides that the contractor shall (a) have a written code of business ethics and conduct; and (b) make a copy of the code available to each employee engaged in performance of the contract.

In addition, the contractor is required to exercise due diligence to prevent and detect criminal conduct and otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law. Under FAR Clause 52.203-13, the contractor shall timely disclose, in writing, to the agency Office of the Inspector General (OIG), with a copy to the contracting officer, whenever, in connection with the award, performance, or closeout of this contract or any subcontract thereunder, the contractor has credible evidence that a principal, employee, agent, or subcontractor of the contractor has committed:

Construction Practice Notices

Upcoming Presentations

On July 14, 2011, Anita Ponder will host Seyfarth’s Government Contractors Business Forum on Illinois Department of Transportation contracting opportunities and the SBA’s new Women-Owned Small Business Federal Contract Program. Anita Ponder also prepared a summary of the SBA program, which was published by Seyfarth Shaw in July 2011.

Recent Presentations

On June 29, 2011, Mark Lies conducted a webinar for Arthur J. Gallagher’s Premium Insureds on “Terminating the Accident Prone Employee.”

On June 16, 2011, Anita Ponder hosted Seyfarth’s Government Contractors Business Forum on Cook County government contracting opportunities.

On May 18, 2011, Anita Ponder hosted, and Jerry Buch and Mark Johnson spoke at, Seyfarth’s Government Contractors Business Forum on the ongoing O’Hare Modernization Program.

On May 10, 2011, Mark Lies spoke at the Chicagoland Construction Safety Council on OSHA liability.

On January 14, 2011, Mark Johnson spoke at a seminar sponsored by Lorman Education Services, entitled “AIA Contracts: The Owner-General Contractor Agreement.”

(A) A violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code; or

(B) A violation of the civil False Claims Act (31 U.S.C. 3729-3733).

Again, the terms “timely disclose and “credible evidence” are not defined and are left to the contractor’s judgment. In order to encourage disclosures, and to the extent permitted by law and regulation, FAR 52.203-13 provides that the government will safeguard and treat information obtained pursuant to a contractor’s disclosure as confidential where the information has been marked as “confidential” or “proprietary” by the company making the disclosure. To the extent permitted by law, the government will not release the disclosed information pursuant to a Freedom of Information Act request, without prior notification to the contractor.

Code of Business Ethics Awareness and Compliance Program

Except for contractors who have represented themselves as a small business concern pursuant to the award of a contract or if the contract is for the acquisition of a commercial item, contractors are also required to take certain additional steps to implement their obligations noted above. Unless the contracting officer establishes a longer time period, a contractor shall establish an ongoing business ethics awareness and compliance program within 90 days after contract award. This program shall include reasonable steps to communicate periodically and in a practical manner the contractor’s standards and procedures and other aspects of the contractor’s business ethics awareness and compliance program and internal control system, by conducting effective training programs and otherwise disseminating information appropriate to an individual’s respective roles and responsibilities. The training conducted under this program shall be provided to the contractor’s principals and employees, and as appropriate, the contractor’s agents and subcontractors.

The term “principal” is defined by the FAR as an officer, director, owner, partner, or a person having primary management or supervisory responsibilities within a business entity (e.g., general manager; plant manager; head of a division or business segment; and similar positions). The term “subcontractor” means any supplier, distributor, vendor, or firm that furnishes supplies or services to or for a prime contractor or another subcontractor.

Internal Control System

Also within 90 days after contract award, a contractor is required to establish an internal control system, which shall (a) establish standards and procedures to facilitate timely discovery of improper conduct in connection with Government contracts; and (b) ensure corrective measures are promptly instituted and carried out. The FAR also includes minimum standards for a contractor’s internal control system, including the following:

- Assignment of responsibility at a sufficiently high level and adequate resources to ensure effectiveness of the business ethics awareness and compliance program and internal control system;
- Reasonable efforts not to include an individual as a principal, whom due diligence would have exposed as having engaged in conduct that is in conflict with the contractor’s code of business ethics and conduct;
- 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, including:
 - Monitoring and auditing to detect criminal conduct;



- Periodic evaluation of the effectiveness of the business ethics awareness and compliance program and internal control system, especially if criminal conduct has been detected; and
- Periodic assessment of the risk of criminal conduct, with appropriate steps to design, implement, or modify the business ethics awareness and compliance program and the internal control system as necessary to reduce the risk of criminal conduct identified through this process.
- An internal reporting mechanism, such as a hotline, which allows for anonymity or confidentiality, by which employees may report suspected instances of improper conduct, and instructions that encourage employees to make such reports;
- Disciplinary action for improper conduct or for failing to take reasonable steps to prevent or detect improper conduct;
- Timely disclosure, in writing, to the agency OIG, with a copy to the contracting officer, whenever, in connection with the award, performance, or closeout of any government contract performed by the Contractor or a subcontract thereunder, the contractor has credible evidence that a principal, employee, agency, or subcontractor of the Contractor has committed a violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 U.S.C. or a violation of the civil False Claims Act (31 U.S.C. 3729-3733):
 - If a violation relates to more than one government contract, the contractor may take the disclosure to the agency OIG and contracting officer responsible for the largest dollar value contract impacted by the violation.
 - If the violation relates to an order against a government-wide acquisition contract, a multi-agency contract, a multiple-award schedule contract such as the Federal Supply Schedule, or any other procurement instrument intended for use by multiple agencies, the contractor shall notify the OIG of the ordering agency and the IG of the agency responsible for the basic contract, and the respective agencies' contracting officers.
 - The disclosure requirement for an individual contract continues until at least 3 years after final payment on the contract.
- Full cooperation with any government agencies responsible for audits, investigations, or corrective actions.

The FAR also requires that a contractor shall include the substance of clause 52.203-13 in subcontracts that have a value in excess of \$5,000,000 and a performance period of more than 120 days.

DCAA Audit Guidance

The Defense Contract Audit Agency (DCAA) has been charged with monitoring compliance with the above requirements on Department of Defense contracts. In order to facilitate its audits, DCAA has issued “guidance” to its auditors in connection with their review of contractors’ compliance programs. Among other things, DCAA auditors are instructed to verify the existence of written codes of business ethics and conduct, and to review the contents thereof to ensure compliance with the requirements of FAR 52.203-13.

DCAA auditors are also instructed to investigate each aspect of the Contractor’s business ethics awareness and internal control system. Importantly, DCAA has identified the following minimum levels of compliance that its auditors are expected to confirm:

- Assignment of responsibility at a sufficiently high level to ensure the effectiveness of the business ethics awareness and compliance program and internal control system. The manager responsible for the ethics program should report to a high level official such as the vice president or CFO.
- Procedures to ensure individuals that previously engaged in conduct that conflicts with the contractor’s code of business ethics and conduct are not appointed as a principal of the company. Auditors should review the contractor’s policies and procedures and test the procedures to verify that they include steps for exercising due diligence in identifying such conduct (e.g., require background checks before appointing principals of the company) and that steps have been taken when applicable.
- Periodic evaluations (i.e., at least annually) of the effectiveness of the business ethics and awareness compliance program and internal control system. Auditors should review the results of these evaluations and determine the impacts on any audits. For example, if the contractor’s recent evaluations disclosed weakness in the contractor’s internal control system, the auditor should ensure that the contractor has taken the necessary corrective action to address these weaknesses.
- Disciplinary action for improper conduct, or failing to take reasonable steps to detect improper conduct. Auditors should request the contractor to provide evidence of the assessment performed to determine if disciplinary action taken was needed, and evidence of the disciplinary action taken, if applicable. Auditors should remember that it is appropriate for contractors to remove Personally Identifiable Information (PII) before submitting documentation to the auditor. If the contractor states that no disciplinary action was needed, the auditor should take steps to ensure that there were no reports of improper conduct by the contractor. If the auditor finds that there is a report of improper conduct and the contractor failed to take disciplinary action when it should have been taken, the auditor should cite the contractor for an internal control deficiency.

Construction Practice Recent Publications

2011 Fifty State Lien Law Notice Requirements: This survey was prepared for use primarily by commercial contractors and real estate developers on non-public projects. The quick reference table format describes general time requirements for filing lien notices in each state.

Green Building Addendum for Construction Contracts: This Addendum provides owners and developers with a comprehensive and integrated solution for their construction contracts and addresses a variety of issues, including; definitions for green building issues, the submittal process for green building components and scheduling issues concerning green components and processes.

- With respect to disclosures of credible evidence of a violation of a Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 U.S.C. or a violation of the civil False Claims Act:
 - Auditors should ensure the contractor's policies and procedures include a reasonable definition of credible evidence, and a reasonable timeframe for disclosure once credible evidence is obtained.
 - Contractor's are allowed to take time for a preliminary examination of the evidence to determine its credibility prior to disclosure. Once the Contractor had had sufficient time to take reasonable steps to determine that the evidence is credible, the Contractor should disclose the violation in a timely manner.
 - Auditors should verify that the contractor did not delay in disclosing the violation once it was determined that credible evidence exists. If the auditor finds that the contractor failed to disclose the violation in a timely manner, and internal control deficiency should be reported.
 - Review any disclosures reported to OIG and contracting officer and ascertain if the contractor has taken the necessary corrective actions to protect the Government's interests. If the contractor has not taken the appropriate corrective action, the auditor should report this as an internal control deficiency. If any deficiencies are identified related to the requirement for timely disclosure to the agency OIG, then the DCAA Justice Liaison Auditor will be included on the distribution for the audit report.

Full cooperation is required with any Government agencies responsible for audits, investigations, or corrective actions. If there are known cases where the contractor has not cooperated with audits or investigations, the contractor should be cited for deficiency related to its control environment. Auditors should confirm that there are no outstanding access to records or subpoenas that would indicate the contractor's lack of cooperation.

Finally, Contractors should note that some DCAA auditors have already taken very aggressive positions in reviewing contractors' compliance with the requirements of FAR 52.203-13, and the DCAA and other federal auditors have been charged with vigorously verifying contractor compliance programs going forward. This has resulted in, and will continue to result in, increased requests for access to contractor records. While contractors are required to cooperate with agencies responsible for audits, contractors should know their rights with respect to the disclosure of materials to the government in order to work constructively with DCAA or other auditors while legally protecting their interests.

Summary

Although the federal government's significant expenditure of funds for construction over the past few years for construction is welcomed, there is no doubt that the government's business ethics and disclosure requirements discussed above have substantially increased the risk and compliance obligations of government contractors. All current and potential government contractors should be aware of these requirements in the planning and performing of their work. Seyfarth Shaw LLP's construction and government contract attorneys are experienced with respect to these issues and are available to assist with any questions or issues that you may have.

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