Mandatory Disclosures for Federal Government Contractors: What, How, and When?

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Overview

- Statistics of Interest
- Disclosure Obligations
- Whistleblower World
- DOJ Policy Changes
- Tips to Mitigate Risks
Statistics

- **DOD IG**
  - Over 5,700 contacts to the DOD Hotline from Oct. 1, 2017-Mar. 31, 2018
    - Most related to personnel misconduct, personnel-related matters, reprisal complaints, and improper procurement or contract administration matters
  - 940 whistleblower reprisal complaints to DOD IG or Component IG
    - 84 concerned defense contractor reprisal
  - 113 contractor disclosures, as required by FAR 52.203-13
    - Largest percentage of disclosures related to labor mischarging (68%)
    - Fewer than half the reports than from one year ago (274 in Oct. 2016-Mar. 31, 2017)

- **GSA IG**
  - 5 contractor disclosures received Oct. 1, 2017-Mar. 31, 2018
    - Also less than year ago (7 for period Oct. 2016-Mar. 31, 2017)
  - Concluded evaluation of 8 disclosures, recovering over $1.4 million (M)
Statistics

- Dec. 21, 2017: **Department of Justice (DOJ) reports** False Claims Act recoveries for Fiscal Year (FY) 2017
  - $3.7 billion (B) (one billion less than FY2016)
    - $2.4B from health care industry, including drug companies, medical device companies, hospitals, nursing homes, labs, and physicians
    - $543M from financial industry re housing and mortgage fraud
    - Procurement fraud recoveries ran the gamut:
      - $95M (plus foregoing $249M in claims) to resolve allegations of overcharging for local produce provided to soldiers in Iraq/Kuwait
      - $125M to resolve allegations that charged DOE for deficient nuclear quality materials
      - $45M to resolve allegations that made false statements and claims to GSA in negotiation of software licenses
      - $29.5M to resolve ARRA overcharging allegations
      - $16M to resolve allegations involving small business program eligibility
Statistics

- **DOJ (cont’d)**
  - Whistleblowers filed 669 *qui tam* suits in FY2017 – “an average of more than 12 new cases every week”
    - Of the $3.7B recovered, $3.4B related to *qui tam* suits
      - Even though FCA recoveries overall declined, *qui tam* suit recoveries *increased* ($3.4B in FY2017 vs. $2.9B in FY2016)
    - DOJ paid out $392M to whistleblowers

- **ISDC**
  - Agency suspensions and debarments decreased 14% in FY2017 over FY2016 (604 suspensions, 1613 proposed debarments, and 1423 debarments in FY2017)
    - Even decreased numbers represent nearly double the activity reported in FY2009, when the ISDC began tracking this data
  - Proactive outreaches by contractors before a debarring official raises concerns also decreased from 76 to 53 between FY2016 and FY2017
  - Pre-notice letters (e.g., show cause) increased 21%
FAR Mandatory Disclosure

- FAR 52.203-13, Contractor Code of Business Ethics and Conduct
  - Business ethics awareness and compliance program, generally tracks Federal Sentencing Guidelines requirements for effective compliance and ethics program
  - Internal control system that allows the company to timely discover improper conduct
- Mandatory Disclosure Requirements in FAR 52.203-13:
  - Must “timely” disclose “credible evidence” of certain procurement-related federal criminal violations and violations of civil False Claims Act to Agency Office of Inspector General (OIG)
FAR Mandatory Disclosure

- Mandatory Disclosure Requirements in FAR 52.203-13 (cont’d):
  - Applies to all covered contracts (>5.5M and 120 days), and must be flowed down to covered subcontractors
    - Although small businesses and commercial item contracts exempt from 52.203-13(c) compliance program and internal controls requirements, not exempt from mandatory disclosure obligations. See FAR 52.203-13(b)
  - Noncompliance with disclosure obligation is ground for suspension/debarment under FAR 9.4 (knowing failure of “principal” to “timely” disclose “credible evidence” of enumerated procurement-related and significant overpayments)
How Do You Know What To Disclose?

- Guiding Principles:
  - Policy and practice must encourage reporting. If you see something, say something.
  - The goal is to be proactive, not reactive.
  - How would you explain to a neutral third party a decision NOT to disclose?
  - Bad news does not get better with age.
  - The “cover-up” is worse than the crime.
FAR Mandatory Disclosure: Managing the Investigation

- Overview of structure of corporate/internal investigations at BAE Systems
  - Chain of command
- Initiation of investigation: the intake process
- Who investigates?
- How are investigations tracked?
  - “Timely” not defined in rule or preamble (73 Fed. Reg. 67064 (Nov. 12, 2008))
  - Rule contemplates sufficient time to conduct investigation to determine whether “credible evidence” exists
  - “Reasonable steps that the contractor considers sufficient to determine that the evidence is credible”
FAR Mandatory Disclosure: Managing the Investigation

- Use of templates, scripts
- How to handle employees who are reluctant to talk to internal/external investigators or who might be involved in wrongdoing?
- How are investigations findings and results documented?
- When to hire outside counsel
- When to hire other outside professionals (computer forensics, accountants)
FAR Mandatory Disclosure: Managing the Disclosure

- **What is the process for determining whether a disclosure is required?**
  - Internal coordination of decision-making
  - Obligation rests with the “principals” of the company. What is a “principal”? Net is cast both broadly and ambiguously
    - “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)

- **Drafting the disclosure**
  - Use and views on “batch” disclosures
  - Standard letter format?
  - Remedial measures in disclosures?
  - Discipline discussed in disclosures?
Disclosures to DOD IG are sent to DOJ and Agency SDO as matter of course
- DCIS and DCAA may also become involved
- DOD IG practice to promptly send letter that their office is “coordinating with the Department of Justice and Defense agencies with equities or interest in the disclosure”
- Routine to route disclosures to civil/criminal DOJ
- Does not necessarily mean a DOJ judgment has been made
FAR Mandatory Disclosure Insights

- All mandatory disclosures are reviewed in the Criminal Division by the Fraud Section in Washington.
- Very few disclosures result in cases being opened by criminal prosecutors. Many more are acted on by DOJ Civil.
- Vast majority of disclosures are time charging violations, many very minor. Vast majority of them indicate discipline had been handed out.
- Cases that are further criminally investigated are brought to DOJ attention by OIG or picked up from a *qui tam*, not on basis of mandatory disclosures.
FAR Mandatory Disclosure Insights

- Characteristics of a criminal case:
  - Loss (greater flexibility when conduct threatens a government mission)
  - Pervasiveness of misconduct
  - Clarity of contractual or regulatory “ground rules”
  - Presence or absence of certifications
  - Internal communications (emails, recorded calls, etc.)
  - Evidence of concealment
FAR Mandatory Disclosure Insights

- DOD IG requires information on individuals involved in disclosed conduct
  - Often leads to inquiry from SDO regarding present responsibility of individuals
  - May affect security clearance
- Discipline is two-edged sword
  - Discipline expected by some regulators; others may not think it is enough (i.e., scapegoat or larger organizational issue?)
FAR Mandatory Disclosure Insights

- Remedial measures?
  - If you make a disclosure, behooves you to address consideration/remediation
    - Prevent retention of an overpayment
    - Address the matter “timely”
    - Get ahead of the SDO

- Close Out Notice?: DOD IG and GSA IG state that they generally provide written notice to contractor if agency decides to close a disclosure
FAR Mandatory Disclosure Insights

- Regulator position: no *de minimis* amount
  - Some regulators bemoan the quantity of disclosures vs. quality of disclosures
  - Some regulators question whether “all” misconduct reported
- Your idea of “credible evidence” may not be the same as the regulator’s view
  - Overly legalistic analysis?
  - How will you explain the failure/absence of a disclosure to a regulator?
- Subcontractor disclosures
  - Upstream FCA implications for prime
  - Advance notice to the subcontractor?
Other Sources of Disclosure Obligations

- **Grants, 2 C.F.R. 200.113**
  - Requires organization to disclose “in a timely manner” to the awarding agency or pass-through entity “all violations of federal criminal law involving fraud, bribery, or gratuity violations potentially affecting the federal award”

- **DFARS rule promoting “voluntary post-award disclosure of defective pricing,” finalized May 4, 2018, DFARS 215.407-1(c)(i)**
  - Relates to findings of defective pricing when contractor provided certified cost or pricing data
  - To promote voluntary contractor disclosures of defective pricing, gives DOD contracting officers discretion to discuss disclosure with DCAA and, as necessary, request a limited-scope or full-scope audit

- Disclosure to CO
Other Sources of Disclosure Obligations

- **Overpayments, FAR 52.232-25(d)**
  - If Contractor becomes aware of a duplicate contract financing/invoice payment or that Government has otherwise overpaid, Contractor must remit overpayment with a description of the circumstances of the overpayment, affected contract/deliver order and line items along with supporting documents.
  - Disclosure to CO

- **Reps and Certs in SAM and FAPIIS, e.g., FAR 52.209-5 and 52.209-7 (Responsibility Matters)**
Other Sources of Disclosure Obligations

- **Anti-Kickback Act, 41 U.S.C. §§ 8701-8707, implemented in FAR 3.502, Subcontractor Kickbacks, and FAR 52.203-7**
  - Disclosure obligations similar, but not identical, to mandatory disclosure. See 41 U.S.C. § 8703; FAR 3.502-2(g) and FAR 52.203-7(c) (2)
    - “reasonable grounds to believe” standard
  - Criminal, civil, and administrative penalties

- **Combating Trafficking in Persons, FAR Subpart 22.17 and FAR 52.222-50**
  - FAR 52.222-50(d) requires contractor to: (1) “notify” CO and Agency OIG of any credible information that a contractor employee, subcontractor employee or agent has engaged in conduct that violates 52.222-50(b) (policy and list of prohibited conduct); and (2) any actions taken against a contractor employee, subcontractor employee or agent pursuant to clause
Other Sources of Disclosure Obligations

- SEC Disclosure Obligations
  - Do you have to disclose allegation of fraud, a CID, or an SEC subpoena?
    - It depends, but generally no automatic duty to disclose
  - Have to disclose if there is a Rule, such as “material” legal proceedings in SEC Regulation S-K, Rule 103
  - Have to disclose if failing to do so would render another disclosure misleading
  - Investigation could reveal internal control failings requiring disclosure
Disclosures in a Whistleblower World

**SEC Whistleblower Program**

- Over 4,400 whistleblower tips in FY2017
  - Number of tips has increased every year since FY2011
  - 50% more than first year with full program data (FY2012)

- In FY2017, Corporate Disclosures and Financials accounted for highest percentage (19%) of complaint type; Offering Fraud was second most common complaint (18%); Manipulation was third (12%)

- In FY2017, SEC awarded $50M to 12 individual whistleblowers
  - Three of the ten largest awards were in FY2017
  - $322M awarded to 58 whistleblowers since program inception
DOJ Corporate Enforcement Policy

- Corporate criminal liability is resolved through either indictment, guilty plea, deferred prosecution agreement, non-prosecution agreement, or declination
- Outcome depends on “Filip Factors” listed in USAM 9-28.300
  
  • Nature and seriousness of offense
  • Pervasiveness of wrongdoing and managerial involvement
  • History of misconduct
  • Cooperation
  • Existence of effective compliance program
  • Timely and voluntary disclosure
  • Remedial actions
  • Collateral consequences to public and shareholders
  • Adequacy of other remedies, such as civil enforcement or debarment
  • Adequacy of prosecution of individuals
Factor Four: Cooperation

- Cooperation is connected to the adequacy of criminal prosecution (“Yates Memo”)

- Cooperation generally involves:
  - Revealing results of internal investigation (without waiver of privilege)
  - Review and disclosure of emails; documents; and audio files (litigation holds are essential)
  - Making current employees available for interview
  - Coordination of interviews with DOJ (tip: adverse employment actions and public filings may impact investigation)
  - Assessment of loss
  - Cooperation in court processes

- Continued cooperation through DPA or NPA agreements
Factors Five and Seven: Compliance Policies

- Fraud Section Guidance on “Evaluation of Corporate Compliance Programs” (available online) issued in February 2017
- Includes 11 key compliance metrics and a set of “common questions” that DOJ considers in assessing compliance programs; DOJ prosecutors and consultants will test these 11 factors:
  - Analysis and Remediation of Underlying Misconduct (“how did this slip through?”)
  - Involvement of Senior and Middle Management in the compliance program.
  - Autonomy and Resources of compliance program (independence and resources)
  - Policies and procedures (including identification of who at the company was responsible for integrating policies into the compliance program)
  - Risk assessment (e.g., identifying problem areas by geography or industry)
  - Training and Communication
  - Confidential Reporting and Investigation (avenues to report misconduct)
  - Incentives and disciplinary measures (bonuses, promotions, termination)
  - Periodic testing and review
  - Third party management (watching the subs)
  - Mergers and Acquisitions
How Do You Manage/Mitigate The Risks?

- Careful preparation of disclosures given wide audience
  - Just the facts
    - Facts are not privileged
      - Avoid admissions and waiver of privilege
    - Truthfulness
    - Completeness
    - Remedial/corrective actions
  - Ducks in a row BEFORE disclosure
    - Balance “timely” with sufficient understanding of facts
    - Consider preliminary disclosure for complex/lengthy investigations
How Do You Manage/Mitigate The Risks?

- Understand and anticipate that employees identified in disclosure may find themselves contacted by regulators
  - Effective internal investigation before disclosure
  - Be prepared for “target” to claim status as “whistleblower” and have in place anti-retaliation policies
  - Is the misconduct of a single employee a broader indicator of misconduct within the organization?
  - If that employee is the target of enforcement actions (e.g., suspension/debarment), what is the company’s policy and response?
How Do You Manage/Mitigate The Risks?

- Disclosures include more than just FAR mandatory disclosure obligation
  - E.g., various SAM/FAPIIS and other reps and certs are numerous and can be complicated. Include update requirements as well

- Be on the lookout for other disclosure “opportunities”
  - Pre-acquisition due diligence may uncover corrupt payments where disclosure could result in DOJ/SEC declination
  - Pair disclosure decision with compliance review and remediation