

Why Do Good Contractors Get In Trouble?

Law360, New York (April 10, 2012, 1:20 PM ET) -- By regulation, federal government contractors are required to be honest and have integrity.[1] That is not a goal; it is, in theory, a mandate. That mandate is supported by laws prohibiting bribes, gratuities, kickbacks, conflicts of interest and other nefarious conduct that would undermine the integrity of public procurements.

According to the government, “[t]he public demands honesty and integrity in corporations with which the Government does business.”[2] And, since 2008, the government has required its contractors, with very limited exceptions, to have written codes of conduct, compliance programs and internal controls designed to ensure that contractors and their employees behave ethically or timely figure out — and tell the government — when they don’t.[3]

Against that backdrop, the number of reports of questionable conduct by contractors, their employees and/or their government counterparts that are covered by the media is surprising. By way of example, as this article is being penned, the media is widely reporting a “spending scandal” at the General Services Administration that cost at least two employees their jobs and resulted in the resignation of the GSA administrator.[4]

In addition to excessive spending, the GSA inspector general found that GSA personnel violated procurement laws by telling a bidder the amount of a competing bid and arguably promising special treatment to another contractor in connection with future work.[5] The bidder that received that inside information about the competing bid received the contract at issue.

Similarly, earlier this year, a division of a large contractor was proposed for debarment because a new hire, who was a former government employee, allegedly brought proprietary pricing information of a competitor with him to his new job and shared it with others on the proposal team organized to compete for the work to which the information related. The information reportedly was analyzed, and the new hire was appointed to a position on the proposal team before the improper disclosure of the competitor’s pricing information ultimately was reported to the legal department.[6]

There can be no doubt that a robust ethics and compliance program, complete with internal controls, can be effective and protect a company’s bottom line. An anonymous call to the company hotline that is taken seriously by the company, investigated and addressed if warranted may avoid a qui tam action by the reporting employee. In the same vein, timely corrective action taken by the company in response to discovered misconduct may be the difference between continued performance as a federal government contractor and suspension or debarment of the company.

But what about those “good” companies that seem to do everything right? They have an ethics and compliance program. They conduct regular training. They thoroughly investigate complaints. Despite that, they sometimes still wind up on the receiving end of a suspension action, a qui tam suit and bad publicity. Could they do more?

There is an open question of whether the key to ensuring honesty and integrity of federal government contractors and their employees is by making ethics and compliance programs mandatory contractual requirements. The current mandatory contractor code of business ethics, compliance program and internal control regime “does not prescribe specific ethical requirements.”[7] It is “a framework for institutional ethics management and disclosure” only.[8] In fact, the framework largely mirrors an analogous voluntary system that was adopted by major defense contractors in the 1980s and 1990s.[9] That voluntary system was analyzed and reported by the president’s Blue Ribbon Commission on Defense Management in 1986.[10]

At that time, widespread stories of “[t]he falsification of timecards and test results, poor quality controls, defective pricing, waste, fraud, abuse, and overall mismanagement of defense contracts” reportedly had “incensed the general public, the Congress, and the Administration.”[11] In response, a number of federal defense contractors organized and pledged to adopt and implement principles in ethics and business conduct that closely resemble the framework that now is mandatory. One notable exception was that the 1986 ethics principles provided for voluntary reporting of federal procurement law violations instead of the mandatory disclosure rule that now is in effect.[12]

In the foreword to the 1986 Blue Ribbon Commission’s final report, Chairman David Packard concluded:

Defense contractors and DoD must each assume responsibility for improved self-governance to assure the integrity of the contracting process. Excellence in defense management will not be achieved through legions of government auditors, inspectors, and investigators. It depends on the honest partnership of thousands of responsible contractors and DoD, each equally committed to proper control of its own operations.[13]

The commission similarly observed:

Though government oversight is critically important to the acquisition process, no conceivable number of additional federal auditors, inspectors, investigators, and prosecutors can police it fully, much less make it work more effectively. Nor have criminal sanctions historically proved to be a reliable tool for ensuring contractor compliance.[14]

Indeed, the nonprofit organization that was requested by the commission in 1986 to analyze the formal efforts of defense contractors for ensuring ethical conduct by their employees and companies, cautioned:

The standard of ethical business conduct seems to have become regulatory compliance, rather than responsible decision making. ... The sense of moral agency and ethical responsibility may be overridden by the "gamesmanship" attitude fostered by regulatory adversarialism.

Whatever actions the present Administration or the Congress may take to improve the effectiveness of federal regulations and oversight activities, serious attention must be paid to the inherent limitations and possible counterproductivity of an approach that is almost entirely a matter of external policing.[15]

In 1986, the consensus seemingly was that mandating ethical business conduct was an ineffective tool for ensuring the integrity and honesty of federal government contractors and that "regulatory adversarialism" was not the best path to achieving the same. Indeed, the 1986 Blue Ribbon Commission "believe[d] that self-governance [was] the most promising mechanism to foster improved contract compliance." [16]

Today, in contrast, the Defense Contract Audit Agency instructs its auditors to include review of the Contractor Code of Business Ethics and Conduct, Business Ethics Awareness and Compliance, and Business Ethics Awareness and Compliance Internal Control System as part of any Control Environment and Overall Accounting System Control audit.[17]

Auditors are instructed that "an internal control deficiency should be reported" if the "auditor finds that the contractor failed to disclose [a] violation in a timely manner[.]" [18] Similarly, auditors are instructed to "cite the contractor for an internal control deficiency" if "the auditor finds that there is a report of improper conduct" for which the contractor did not take disciplinary action that should have been taken.[19]

Anecdotally, many government contractors report that their interactions with the government are becoming more adversarial. A recent "Government Contractor Industry Survey" concluded that "[t]he relationship between contractors and government auditors and contracting officers ha[d] deteriorated during the last year." [20] That survey explained:

The relationship with auditors was rated as fair or poor by 19% of the surveyed companies, compared with 11% in the 16th annual survey. The relationship with contracting officers was rated fair or poor by 10% of the participants in the 17th annual survey, compared with 5% in the prior survey.[21]

It is far from clear that an “honest partnership” between the federal government and its contractors will result from increased oversight of contractors’ codes of business ethics and conduct, compliance programs and/or internal controls.

At the end of the day, most contractors readily recognize the benefits gained from implementing ethics and compliance programs with robust internal controls that permit the contractor to address and correct misconduct before it is discovered by the government (or a qui tam plaintiff’s lawyer). Whether by virtue of complying with contractual obligations or avoiding a feature article on the front page of the Washington Post highlighting misconduct, it is in the interest of most federal government contractors to:

- identify activities in their business/industry that may be vulnerable to misconduct and tailor their code of ethics and conduct specifically to address such activities;
- actively (and repeatedly) train employees on the company’s code of ethics and conduct and/or discuss the code with employees;
- create an atmosphere in the workplace where employees can discuss and raise ethical concerns;
- establish and communicate a clear protocol for employees to report possible misconduct to appropriate individuals in the company anonymously;
- establish and communicate “whistleblower” protections for employees that report possible misconduct;
- identify and communicate with employees the sanctions for violating the company’s code — and follow through with appropriate sanctions in the event of misconduct;
- monitor compliance with the company’s code;
- establish and follow uniform procedures for investigating misconduct and disclosing misconduct to the proper government officials when credible evidence exists; and
- monitor and update the code as appropriate.

That brings us back to the question about those good contractors who get into trouble for doing bad things. What is the secret sauce that will prevent that? This is our thought: Companies have to give a strong, unambiguous message to their employees.

When an employee signs an application for employment, he must acknowledge that he will be fired for taking information from a competitor or a former employer. When a company interviews a prospective employee, it has to emphasize the importance of not doing anything of which their mother might disapprove. And there can be no mixed messages.

While it may not be practical to do away with incentives to bring in business, supervisors can be rewarded for ethical conduct and reinforce to employees that theft of competitive information and any other questionable conduct will bring down the employee and could bring down the company. This interaction has to be one on one. Companies that only rely on that very good 100-page compliance manual (that most employees may not even read), may be disappointed — or worse.

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[1] Federal Acquisition Regulation ("FAR") 3.1002(a) ("Government contractors must conduct themselves with the highest degree of integrity and honesty.")

[2] See FAR Case 2007-006, Contractor Business Ethics Compliance Program and Disclosure Requirements, 73 Fed. Reg. 67064, 67071 (Nov. 12, 2008).

[3] FAR 52.203-13.

[4] Lisa Rein and Joe Davidson, GSA chief resigns amid reports of excessive spending, Wash. Post, (April 2, 2012, http://www.washingtonpost.com/politics/gsa-chief-resigns-amid-reports-of-excessive-spending/2012/04/02/gIQAblNnrS_story.html) ("The chief of the General Services Administration resigned, two of her top deputies were fired and four managers placed on leave Monday amid reports of lavish spending at a conference off the Las Vegas Strip . . .").

[5] See GSA Office of Inspector General, Office of Investigations, Management Deficiency Report: General Services Administration Public Building Services, 2010 Western Regions Conferences, at 7 and 8, n.9 (April 2, 2012), available at: <http://www.gsaig.gov/?LinkServID=90537F5B-FBF8-E39E-A4F0D09005742C28&showMeta=0>

[6] See, e.g., Department of the Air Force, Memorandum in Support of the Proposed Debarments of: Booz Allen Hamilton Inc., ***** Only the San Antonio branch . . . [and others], dated Feb. 6, 2012, available at: http://www.federalnewsradio.com/pdfs/BAH_Notice_and_Memo.pdf

[7] See 73 Fed. Reg. at 67067.

[8] Id.

[9] See The President's Blue Ribbon Commission on Defense Management, "A Quest for Excellence, Final Report to the President" ("Blue Ribbon Report"), Appendix M, Defense Industry Initiatives on Business Ethics and Conduct, at 251-253. The Blue Ribbon Report Appendix is available at: <http://www.ndu.edu/library/pbrc/36Ex2AppC1.pdf>

[10] Blue Ribbon Report, at 78-79. The Blue Ribbon Report is available at: <http://www.ndu.edu/library/pbrc/36ex2.pdf>

[11] Blue Ribbon Report, Appendix N, Final Report and Recommendations on Voluntary Corporate Policies, Practices and Procedures Relating to Ethical Business Conduct, Prepared by Ethics Resource, Inc., at 261.

[12] Blue Ribbon Report, Appendix M, at 251.

[13] Blue Ribbon Report, at xiii.

[14] *Id.* at 77-78 (emphasis added) (footnote omitted).

[15] Blue Ribbon Report, Appendix M, at 261.

[16] Blue Ribbon Report at 84.

[17] See, e.g., DCAA Contract Audit Manual ("DCAA Manual"), ¶ 5-306 (Dec. 7, 2011), available at: http://www.dcaa.mil/cam/Chapter_05_-_Audit_of_Accounting_and_Management_Systems.pdf

[18] *Id.* at ¶ 5-306.3a.(6).

[19] *Id.* at ¶ 5.306.3a.(4).

[20] Grant Thornton, Industry Survey Highlights 2011, 17th Annual Government Contractor Industry Survey Highlights Book, at 3, available at: <http://www.grantthornton.com/staticfiles/GTCom/Government%20contractors/FINAL17thSurveyCoverhighlightsSMALLcomplete.pdf>

[21] *Id.*