

**MAJOR NEW COMPLIANCE RULE FOR GOVERNMENT CONTRACTORS**

A major new rule is set to take effect for federal government contractors. The new rule — Federal Acquisition Regulation Subpart 3.10 — will establish a host of new compliance requirements for government contractors and subcontractors. Notably, unlike previous compliance rules, the new rule will apply to both domestic and foreign companies and to both public and private ones. Moreover, it will apply not only to government contractors, but to certain of their subcontractors as well.

As currently drafted, the new rule requires all government contractors with contracts valued over \$5,000,000 (and a performance period of 120 days or more) to (1) have a written code of ethics and business conduct, (2) establish an employee ethics and compliance training program, along with a system of internal controls, (3) display an agency fraud hotline poster, and (4) display a Department of Homeland Security (“DHS”) disaster assistance poster. The new rule will require the contractor’s internal controls system to (1) facilitate timely discovery and disclosure of improper conduct in connection with government contracts, and (2) ensure that corrective measures are promptly instituted and carried out.

In requiring companies to institute effective internal controls, the proposed rule provides a series of examples of suggested controls. These include (1) periodic reviews of company business practices, procedures, policies, and internal controls for compliance with the contractor’s code of ethics and business conduct (and the special requirements of government contracting), (2) an internal reporting mechanism, such as a hotline, by which employees may report suspected instances of improper conduct, along with instructions that encourage employees to make such reports, (3) internal and/or external audits, as appropriate, (4) disciplinary action for improper conduct, (5) timely reporting to appropriate government officials of any suspected violations of law in connection with government contracts or any other irregularities in connection with such contracts, and (6) full cooperation with any government agencies responsible for either investigation or corrective actions.

Although the proposed rule focuses on contracts valued over \$5,000,000, it also requires government contractors with contracts valued under \$5,000,000 to display the DHS disaster assistance and fraud hotline posters described above. The proposed rule also requires such contractors to “conduct themselves with the highest degree of integrity and honesty” and suggests they should implement the codes, training programs, and internal controls outlined above.

To enforce the new rule, the government will include contractual terms covering the provisions described above in future government contracts. Failure to comply would allow the government to (1) withhold contract payments, (2) refuse to pay a contract award fee, (3) terminate the contract, and/or (4) ban the contractor from future contracts. The rule would require contractors to insert similar provisions in subcontracts exceeding \$5,000,000, except in subcontracts (1) involving the acquisition of commercial items, (2) performed entirely outside the United States, and (3) performed in a period of less than 120 days.

The proposed rule will affect at least 10,000 companies, including many small and mid-sized businesses. In addition, it would subject government contractors to substantial additional penalties for noncompliance. For example, if a company represented that it had implemented each of the required controls, and the government determined that the company in fact had failed to do so, then the company could find itself subject to a lawsuit under the False Claims Act, filed either by a whistleblower or the government itself. If found liable, the contractor could be subject to fines, penalties, and damages, potentially including treble damages, in addition to the potential contract-related penalties described above.

The new rule is anticipated to take effect in late November when final review of the rule has been completed; at that time, the rule will be published in the Federal Register. Companies to which this rule will apply should begin examining their compliance programs now to ensure they meet these new requirements.

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