

BRIEFING PAPERS[®] SECOND SERIES

PRACTICAL TIGHT-KNIT BRIEFINGS INCLUDING ACTION GUIDELINES ON GOVERNMENT CONTRACT TOPICS

Suspension, Debarment, Procurement Fraud, And Government Contractor Transactions

By David Robbins*

Exclusions from government contracting by suspensions and debarments, as well as by procurement fraud investigations and enforcement actions, can scuttle pending corporate transactions. This BRIEFING PAPER discusses the interactions between (a) government contractors and their purchasers on the one hand, and (b) government Suspending and Debarring Officials (SDOs,) SDO staffs, and the government's procurement fraud remedies apparatus on the other, in the context of corporate transactions.

Understanding the interests of the various public and private stakeholders is important to breaking down barriers to effective communication and increasing the chances of closing transactions.

Common aspects of diligence in the context of government contracts transactions include understanding which risks may impact a contractor's ability to compete for, and win, new government contracts and what potential liability may exist for past misconduct. Quantifying those risks can be challenging given the opacity of much of the government's procurement fraud and suspension/debarment operations. This PAPER will identify the more common categories of interaction as they relate to government contractor corporate transactions and provide guidelines for facilitating efficient interactions with SDOs, their staffs, and the government's procurement fraud apparatus.

About Suspension And Debarment

Suspensions and debarments are temporary exclusions from new government contracts, generally lasting up to three years.¹ Causes for exclusion can include, but are not limited to, commission of certain civil and criminal frauds and overcharging the government.² There is also a broad catch-all provision that permits exclusions in the discretion of the suspending and

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debaring official based on “any other cause of so serious or compelling a nature that it affects the present responsibility of the contractor or subcontractor.”³ This catch-all provision is the most challenging for parties to a pending transaction to deal with.

About The Government’s Procurement Fraud Remedies Apparatus

Suspension and debarment is just one element of the government’s varied and occasionally disjointed procurement fraud apparatus. The list of stakeholders is long and made up of myriad different stakeholders such as auditors, contracting officials, lawyers, investigating agents, suspension and debarment officials, and the Department of Justice (DOJ). Some agencies, especially the Military Departments, have additional officials who coordinate disparate functions and stakeholders.⁴ Any one of these stakeholders can create risks for pending transactions.

The remainder of this PAPER will address common categories of communication between companies undergoing corporate transactions and the government’s procurement fraud apparatus and provide tips and tricks for more effective and efficient interactions.

Compliance Issues Uncovered During Diligence

Pre-transaction diligence frequently uncovers government contracting compliance issues. While the full range of these issues varies widely, more common issues can include accuracy of business size representations, contract noncompliance, quality deficiencies, and cost and pricing irregularities. Each of these issues has the potential to result in procurement fraud enforcement action

(including False Claims Act⁵ actions) as well as exclusion through suspension and debarment. Regardless of their type, common steps exist to address compliance issues uncovered during diligence.

Assuming the compliance issue is material to the pending deal, the parties will likely want to investigate the source, duration, and the potential contract noncompliance. At a minimum, the buyer and the seller will both want to know how big the issue is, how many contracts are affected, and what contract terms, regulations, and laws might be impacted. This will permit the parties to conduct separate analysis of the potential financial and reputational impacts of the noncompliance and to adjust their strategies accordingly.

Potential purchasers frequently require contractors to disclose noncompliance to the government customer prior to closing. By placing the noncompliance on the government’s radar, the purchaser may obtain a sense of how serious the issue is in the eyes of enforcement officials. The government’s response may impact deal strategy. Additionally, purchasers may also require sellers to obtain comfort that the issue is over and will not present additional risks before a transaction closes.

Multiple options exist for communicating government contract noncompliance to the customer. The most common is through the Mandatory Disclosure Rule. The Mandatory Disclosure Rule requires timely disclosure of credible evidence of, among other things, civil False Claims Act violations, certain violations of criminal law, and significant overpayments to the cognizant contracting officer as well as to the relevant Office of Inspector General.⁶ Other avenues include conversations or emails with the purchasing customer, and/or with the contracting officer.

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Regardless of how contractors choose to communicate noncompliance with the government, both the contracting community and the procurement fraud community will have interest in the communication. These communities work at different paces and have different incentives and goals.

The contracting community's primary focus is on procuring the right goods or services, at the right prices, delivered at the right times. Accordingly, presenting the issues with as little an impact on cost, schedule, and quality as possible increases the chance of contracting community non-objection. If the issue does impact cost, schedule, and/or quality, then a fulsome mitigation plan with aggressive communication regarding the commitment to address any and all impacts of the issue is likely to speed resolution.

The procurement fraud community's goals are different. The goals include coordinating the appropriate mix of all applicable remedies from criminal prosecution to civil fraud recovery to contractual remedies to potential exclusion from contracting through suspension or debarment. None of these remedies are automatic, however. Discretion plays an important role here, too. While the procurement fraud community is focused on returning losses to the government and penalizing misconduct, the community will exercise discretion in the contractor's favor in certain circumstances.

For example, rapid and complete remediation can impress the government's procurement fraud community. There is no specific measure of remediation that contractors can use to know when they have hit the mark. However, the remedial measures and mitigating factors listed at Federal Acquisition Regulation (FAR) 9.406-1(a) are helpful guideposts:

- (1) Whether the contractor had effective standards of conduct and internal control systems in place at the time of the activity which constitutes cause for debarment or had adopted such procedures prior to any Government investigation of the activity cited as a cause for debarment.
- (2) Whether the contractor brought the activity cited as a cause for debarment to the attention of the appropriate Government agency in a timely manner.
- (3) Whether the contractor has fully investigated the circumstances surrounding the cause for debarment and, if so, made the result of the investigation available to the debarring official.

(4) Whether the contractor cooperated fully with Government agencies during the investigation and any court or administrative action.

(5) Whether the contractor has paid or has agreed to pay all criminal, civil, and administrative liability for the improper activity, including any investigative or administrative costs incurred by the Government, and has made or agreed to make full restitution.

(6) Whether the contractor has taken appropriate disciplinary action against the individuals responsible for the activity which constitutes cause for debarment.

(7) Whether the contractor has implemented or agreed to implement remedial measures, including any identified by the Government.

(8) Whether the contractor has instituted or agreed to institute new or revised review and control procedures and ethics training programs.

(9) Whether the contractor has had adequate time to eliminate the circumstances within the contractor's organization that led to the cause for debarment.

(10) Whether the contractor's management recognizes and understands the seriousness of the misconduct giving rise to the cause for debarment and has implemented programs to prevent recurrence.

Contractors will generally be unable to meet each and every one of the 10 factors listed in FAR 9.406-1(a), but the more they are able to meet, the better the communication will be received by the procurement fraud community. The most relevant of the factors are briefly discussed below:

(a) *Whether the contractor had effective standards of conduct and internal control systems in place at the time of the activity or had adopted such procedures prior to any Government investigation.*⁷ This factor is focused on how well designed the contractor's systems were before the misconduct occurred and therefore focuses the government on whether it is reasonable to seek to punish the misconduct or whether discretion is appropriate for a well-meaning mistake that slipped by otherwise robust controls.

(b) *Whether the contractor brought the activity to the attention of the appropriate Government agency in a timely manner.*⁸ By communicating promptly about an issue discovered during diligence, contractors will satisfy this factor's requirements.

(c) *Whether the contractor has fully investigated the*

*circumstances and, if so, made the result of the investigation available.*⁹ There is some tension between the desire for prompt, though possibly incomplete, disclosure under the Mandatory Disclosure Rule and the “full investigation” discussed in this mitigating factor. Nevertheless, keeping the government apprised of key facts in reasonably prompt fashion should earn credit under this factor.

(d) *Whether the contractor has paid or has agreed to pay all criminal, civil, and administrative liability for the improper activity, including any investigative or administrative costs incurred by the Government, and has made or agreed to make full restitution.*¹⁰ The relevant portion of this remedial measure is whether the contractor has made or agreed to make full restitution. To the extent the misconduct involves easily ascertainable amounts of money that are owed to the government, such as in the time mischarging or price reduction contexts, and if the company is financially able to do so, the contractor should consider paying that amount or seeking instructions from the government to pay that amount to earn credit under this factor.

(e) *Whether the contractor has taken appropriate disciplinary action against the individuals responsible for the activity.*¹¹ It is generally not sufficient to disclose facts only. An understanding of root cause and how remediation addresses the root cause is important. Additionally, and relevant to this factor, if the facts do not warrant disciplinary action, the contractor should be prepared to explain why that is the case.

(f) *Whether the contractor has implemented or agreed to implement remedial measures and whether the contractor has instituted or agreed to instate new or revised internal control procedures and ethics training programs.*¹² Related to the last factor, a key component of any government disclosure is to provide an explanation for why the same problem will not reoccur. That same information is helpful here. The government will want the contractor to make appropriate changes to address the misconduct, so the problem cannot reoccur whether or not the deal closes.

Form And Pace Of Interaction

Contractor communications about misconduct are generally made in writing and submitting to the contracting officer at the same time as the relevant Office of Inspec-

tor General is helpful. The SDO staff feels included and is therefore more likely to permit the contractor to frame the issues for the SDO. This, in turn, reduces the chances of exclusion. It is also helpful to place a call to the contracting office in advance of sending them a disclosure document to allow the office to prepare their leadership for the issue and to avoid potential over-reaction brought on by a surprise disclosure.

Once a disclosure is submitted, the contractor can expect prompt interaction with the acquisition stakeholders. It will be comparatively easier to ascertain the acquisition stakeholders’ reactions through normal interactions than it will be to obtain responses from the procurement fraud community. The procurement fraud community will communicate slowly, if at all. Contractors should not expect to receive clearly expressed notifications of the intent of the government’s procurement fraud community. However, familiarity with their processes and relationships with key stakeholders can help contextualize the information contractors do receive.

Parties to a corporate transaction should be aware that, upon receipt of a disclosure, the Inspector General’s office will assign an analyst to track the disclosure. In the Department of Defense context, that analyst will be listed on the response letter the contractor receives after submitting its disclosure. This analyst oversees sending the disclosure to a number of interested government stakeholders, which can include various Offices of Inspectors General, procurement fraud remedies coordinators, the Defense Contract Audit Agency and the Defense Contract Management Agency, relevant SDOs’ offices, and the DOJ Civil Fraud and Criminal Fraud Sections. Each Department of Defense agency is responsible for reporting back to the Inspector General how they are treating the disclosure (e.g., whether or not they are taking action). Therefore, a good relationship with the Inspector General analyst will help inform the contractor of which Department of Defense agencies are interested in the subject matter and therefore might seek to impose a remedy. While the process is somewhat varied in other offices, the communication opportunities with the analyst assigned to a particular disclosure remains fairly consistent.

The DOJ divisions and offices generally work on their own individual timelines, so the risks imposed by DOJ

can be harder to ascertain. However, as a general matter and subject to numerous caveats and context clues, to the extent SDO staffs are actively involved, DOJ may be less interested. Again, subject to numerous caveats, the current group of SDOs are generally less inclined to act before DOJ than prior generations of SDOs may once have been. This can be a helpful context clue for parties to a corporate transaction.

Given the outsized risk that suspension and debarment plays in government contracts, purchasers may wish to obtain as much comfort from the SDO's office as possible about a particular issue prior to closing a transaction. Otherwise, a deal may fail to close, or a substantial amount may be held in escrow pending final resolution. The challenge, depending on the SDO's office involved, is getting the office to provide substantive information. Some SDOs' offices are more inclined to communicate than others, and several offices erect barriers to communication with the SDO themselves (or with any staff members beyond a general workflow inbox).

It can be helpful to send a copy of any disclosure to the relevant SDO's office (e.g., the SDO whose agency is most directly affected and/or that spends the most in annual contract dollars with the contractor) and strike up a dialogue with the assigned staff member to track progress. Understanding that nobody but the SDO can make final decisions on matters, staff-level interaction is a helpful, if caveated, measure of the SDO's viewpoint on a particular matter. Additionally, especially where SDOs appear to be "on the fence" about whether to act against the company, contractors may offer meetings with the head of ethics and compliance at the company and the acquiring entity to discuss post-closure integration. The extra oversight and integration by an entity with more resources and not present during the misconduct can sway SDOs and convince them not to act against the company.

Interactions During Diligence Regarding An Ongoing Investigation

Transactions also take place under the cloud of ongoing government investigations. Communications with SDOs and the procurement fraud apparatus can carry risk as the parties to a transaction seek to understand the scope and potential impact of an ongoing government investigation without impeding the investigation or causing the

government to accelerate its efforts out of concern about the potential impact of a corporate transaction on the government's investigation.

Notwithstanding the risk, acquisitive companies can often require target companies to provide a list of ongoing investigations along with a list of ongoing legal matters. Subject matter experts from the acquiring company will then review all information available to the contractor about the investigation to form independent opinions about the severity, scope, and potential cost associated with the investigation. This impression will be impacted by the government's attitude towards the contractor, the substance of witness interviews (should any exist), and the challenges presented by relevant documents. This interaction typically involves communications with the counsel handling an investigation for the contractor. It is often possible to estimate a range of financial risks from this information.

While the risk of criminal, civil, or contractual liability is often discernible without communication with the government, the risk of suspension or debarment is less so. Increasing the risk to potential acquirers, the suspension and debarment regulations permit imputation and affiliation across a corporate structure. In this author's experience, while it would be unusual for suspending and debarring officials to extend an exclusion to the corporate affiliates of an acquiring entity, it is possible and has occurred previously both purposefully and out of SDO ignorance concerning an acquirer's corporate structure.

Accordingly, purchasers sometimes request that the contractor arrange a meeting with the SDO's staff to obtain a sense of the SDO's posture regarding the underlying misconduct. Absent a preexisting, good relationship with SDO staff, it can be difficult to obtain such a meeting. If the acquirer is prepared to discuss the steps the acquiring company will take to integrate the contractor into the acquirer's existing ethics and compliance program and walk-through steps that can ensure the misconduct will be addressed and cannot reoccur, then a meeting is comparatively more likely. It would not be unreasonable to ask at the end of such a meeting for the steps the acquiring firm and the contractor could commit to taking to convince the SDO that no suspension or debarment action is necessary.

Among the answers a contractor and its acquiring firm

may receive is the SDO's desire to enter into an Administrative Agreement or Compliance Agreement. These agreements often require improvements to the ethics and compliance program of the acquired entity as well as enhanced reporting obligations to the SDO's office. While these agreements might be beneficial in certain circumstances, purchasers have avenues short of such a formal agreement to satisfy SDO concerns without further encumbering the purchased asset for misconduct that the purchaser had no role in perpetrating. These opportunities range from informal exchanges of information, to future scheduled meetings, to written reports, to any other option that seems reasonable under the circumstances. Because Administrative Agreements typically contain obligations that encumber further purchases or sales with additional compliance obligations, many purchasers prefer to come to an understanding with the SDO that does not involve an administrative agreement.

Interactions Regarding An Existing Administrative Agreement

Administrative Agreements commonly have some version of the following clause:

In the event that contractor purchases or establishes new business units or entities during the term of this Administrative Agreement, then the contractor shall implement all provisions of this Administrative Agreement within 60 days. In the event that contractor sells or otherwise divests a portion of its business currently covered by the terms of this Administrative Agreement, then the terms of this Administrative Agreement will follow the sold or divested business. Any bona fide purchaser for value of a portion of the business currently covered by the terms of this Administrative Agreement may petition the agency for release from the terms of the Administrative Agreement in writing.

As a result, purchasers frequently are required to interact with SDOs to either comply with, or petition for exit from, an existing Administrative Agreement. As a general matter, initial interactions that request an exit from an agreement are less well received than an initial interaction that focuses on the agency's interests. For example, an initial outreach asking what gaps, if any, remain of concern to the agency and committing to address them in short order may lead to prompt termination of an Administrative Agreement.

Department Of Justice Compliance Program Guidance Relating To Mergers And Acquisitions

In its June 2020 updates to the DOJ Criminal Division publication, *Evaluation of Corporate Compliance Programs*, DOJ provided substantial detail concerning the Criminal Division's expectations for compliance programs' involvement in the mergers and acquisitions process.¹³ While the document does not specifically address government contractors, it applies broadly across industries, including government contracting. And because the government contracting industry has been consolidating rapidly for years, this DOJ publication merits attention.

"A well-designed compliance program should include comprehensive due diligence of any acquisition targets, as well as a process for timely and orderly integration of the acquired entity into existing compliance program structures and internal controls."¹⁴ DOJ noted that it will take issue with "[f]lawed or incomplete pre- or post-acquisition due diligence and integration" because it "can allow misconduct to continue . . . risking civil and criminal liability."¹⁵

The questions that the Criminal Division will ask regarding diligence are instructive. They are:

Due Diligence Process—Was the company able to complete pre-acquisition due diligence and, if not, why not? Was the misconduct or the risk of misconduct identified during due diligence? Who conducted the risk review for the acquired/merged entities and how was it done? What is the M&A due diligence process generally?

Integration in the M&A Process—How has the compliance function been integrated into the merger, acquisition, and integration process?

Process Connecting Due Diligence to Implementation—What has been the company's process for tracking and remediating misconduct or misconduct risks identified during the due diligence process? What has been the company's process for implementing compliance policies and procedures, and conducting post-acquisition audits, at newly acquired entities?¹⁶

These Criminal Division guidelines become especially relevant once acquiring companies are on notice of a potential issue that might give rise to civil or criminal liability. At a minimum, the Criminal Division's ques-

tions become a helpful checklist for acquiring entities to use in their diligence and integration process. Without satisfactory answers to the Criminal Division's questions, acquiring companies may have a more difficult time arguing that they "bought a problem" and are victims that should not be penalized through fines, penalties, restitution, etc.

Guidelines

These *Guidelines* are designed to assist you in your interactions with SDOs and the government's procurement fraud apparatus in the context of corporate transactions. However, they are not intended to be a substitute for legal advice in any particular situation.

1. Understand the Different Motivations of Government Stakeholders. To the extent that the primary goal of communication with SDOs and the government procurement fraud apparatus during a government contractor transaction is to understand and assess risks, contractors and acquirers should understand that the government is not monolithic. Different stakeholders have different motivations, goals, and communication preferences. Understanding the tendencies of the offices with which a contractor is communicating is important to efficient communication. Better yet, understanding the specific tendencies of individual decisionmakers further enables contractors and their acquirers to assess risk.

2. Understand the Art of the Possible. It is extraordinarily rare for contractors or their acquirers to receive a written "clean bill of health" from government stakeholders following the disclosure of noncompliance. Reading between the lines is often necessary. Clients and counsel should be prepared for this both in terms of what they ask of the government, and how they interpret government responses.

3. Recognize that Government Skepticism Will Impact Communications. As a general matter, contracting offices deal with performance issues regularly and may be more open to discussing potential noncompliance than a procurement fraud office might be. Procurement fraud offices deal with the worst of contractor conduct regularly. Despite best efforts, these offices may assume

the worst. Earning trust may take time and carefully planned communications.

4. If Civil or Criminal Fraud Risk is Present, Consult DOJ Criminal Division Compliance Program Expectations. With its updated guidance concerning effective compliance programs, the DOJ Criminal Division set forth expectations for due diligence. Falling short of these expectations may make DOJ less likely to exercise discretion in favor of an acquirer that "bought a problem."

5. Use Capable Government Contracts Counsel for Specialized Diligence Assistance. Specialized government contracts counsel can help interpret government interactions and place them into context that makes sense for business decisionmakers. Counsel with relationships with government stakeholders are also more likely to receive responses to inquiries. Additionally, the DOJ Criminal Division guidance asks who is performing diligence. Using specialized government contracts counsel able to spot diligence issues may help satisfy DOJ.

ENDNOTES:

¹FAR 9.406, 9.407.

²FAR 9.406-2, 9.407-2.

³FAR 9.406-2(c), 9.407-2(c).

⁴See Department of Defense Instruction 7050.05, "Coordination of Remedies for Fraud and Corruption Related to Procurement Activities" (May 12, 2014; incorporating Change 1, effective July 7, 2020), available at <https://www.esd.whs.mil/Portals/54/Documents/DD/issuances/dodi/705005p.pdf?ver=2020-07-07-065758-907>.

⁵31 U.S.C.A. §§ 3729–3733.

⁶FAR 52.203-13.

⁷FAR 9.406-1(a)(1).

⁸FAR 9.406-1(a)(2).

⁹FAR 9.406-1(a)(3).

¹⁰FAR 9.406-1(a)(5).

¹¹FAR 9.406-1(a)(6).

¹²FAR 9.406-1(a)(7), (8).

¹³U.S. Dep't of Justice Criminal Div., Evaluation of Corporate Compliance Programs (updated June 2020), available at <https://www.justice.gov/criminal-fraud/page/file/937501/download>.

¹⁴Id. at 9.

¹⁵Id.

¹⁶Id.

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