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**30-SECOND SUMMARY** The Buy American Act (BAA) requires the government to buy goods made in the United States. Under the Trade Agreements Act (TAA), the United States can buy a product made or “substantially transformed” in “designated” foreign countries. Whether an item is substantially transformed is a fact-specific inquiry of manufacturing location and processes. Because of these and related compliance assessments, certifications create significant risk for government contractors. Companies should consider using outside counsel when conducting BAA and TAA analyses of products sold to the government. Besides breach of contract, a false certification may lead to criminal and civil liability for the company, as well as those employees involved in making the certification.

# DEVELOPING A COMPLIANCE PROGRAM FOR FEDERAL GOVERNMENT CONTRACTS

By Christopher J. Aluotto

Commercial companies sell billions of dollars’ worth of goods and services to the federal government every year. And for many companies, government sales represent only a small portion of annual revenue.

Government contracts contain risks and liabilities not present in commercial contracts. For example, a contractor giving false or misleading information to the government risks criminal liability, and could be suspended or debarred from public contracting — and breaching a government contract may have the same consequences.

A company with even one government contract should have a compliance plan to manage federal sales risk. That plan should address all the clauses referenced in the contract. Not all clauses present the same risk. This article highlights a few high-risk clauses to consider when developing a government contract compliance plan.

## The Buy American and Trade Agreements Acts

The Buy American Act (BAA) requires the government to buy goods made in the United States. The law applies only to contracts that meet price thresholds listed in the Federal Acquisition Regulation (FAR).<sup>1</sup>

A two-part test is used to determine whether a good is US-made. First, the good must be manufactured in the United States. Whether something is manufactured domestically is ascertained by examining the processes used to construct the item. The regulation does not define manufacturing, and courts and administrative boards provide different definitions. Generally, the place an item is manufactured is the location from where it can be sold to satisfy a requirement.

The second test requires an analysis of the cost of the good's components. Under this test, more than 50 percent of the cost of the components must originate in the United States. (This component test is waived if the good is a commercial, off-the-shelf item.) An item is considered to be of US origin if both tests are met.

Under the Trade Agreements Act (TAA), the United States can buy a product made or "substantially transformed" in "designated" foreign countries.<sup>2</sup> Numerous trade agreements could apply to an acquisition, meaning an analysis of the clauses listed in the contract is required.

The "substantial transformation" test is used to determine whether a product is manufactured in a foreign country. This test originates from a US Supreme Court case that involved an 1890 tariff law. According to the Court, "[t]here must be transformation; a new and different article must emerge, 'having

a distinctive name, character, or use.'"<sup>3</sup> Put another way: Substantial transformation takes place where components are constructed or assembled to form a completed product. Whether an item is substantially transformed is a fact-specific assessment that depends on the manufacturing process.

The BAA and TAA clauses require contractors to certify the manufacturing location of the items that will be supplied under the contract. Government contract certifications create significant compliance risk for government contractors. Besides breach of contract, a false certification may lead to criminal and civil liability for the company, as well as those employees involved in making the certification. A false certification could also lead to suspension and debarment proceedings against the company and culpable employees. Suspended or debarred contractors are ineligible for new contracts.

Given the nature of modern manufacturing, both the BAA and TAA are complex laws that create compliance challenges. Companies routinely "offshore" work to obtain lower costs. And some of the low-cost countries, like China and India, do not have a US trade agreement that addresses government acquisitions. Some manufacturers will partially manufacture an item in low-cost countries and ship the unfinished product to either the United States or a TAA-compliant country for final manufacturing.

Whether enough manufacturing occurs in the final place of manufacturing to qualify the product is an issue your compliance plan must address. Your trade compliance team will likely have data you can use for your compliance assessment.

To manage this risk, prepare a detailed analysis of where each product is manufactured. Interview program or product managers to understand how the product is constructed and from where the components originate. Consider where manufacturing or assembly takes place, and use supply chain managers as a resource, since they know the components' origins. It also helps to make a video of the product during its manufacturing process.

When conducting interviews, consider using a script or slide presentation during your first meeting to convey the importance of your questions. Employees who don't understand the risks of inaccurate information may be less careful when collecting the data you need.

During your analysis, you'll likely receive inconsistent information. Resolve these inconsistencies and thoroughly document your process. BAA and TAA compliance is a high-risk area — inaccurate representations are likely to have adverse consequences that can jeopardize your ability to obtain government contracts. Given the risk, consider using outside counsel to conduct BAA and TAA analyses of products you sell to the government.

## Federal small business programs

The federal government promotes various programs to encourage contracting with small businesses, such as those owned by women, veterans, disabled veterans, and socially and economically disadvantaged individuals. A thorough understanding of the rules of the government's small business programs is critical to your compliance program.

With some exceptions, the federal government relies on businesses to determine whether they qualify under the small business rules. These determinations are made through certifications, which take place at different times during the procurement process. All federal contractors must complete an online registration that



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includes three small business certifications at [www.sam.gov](http://www.sam.gov).

The Small Business Administration (SBA) uses the North American Industry Classification System (NAICS) to create size standards to classify businesses as large or small. This system contains a list of industry sectors, which are subdivided into lists that describe the work performed; each work description is assigned a code.

During the System for Award Management (SAM) registration, choose NAICS codes that best describe the work your company performs, then determine whether your business is small under those codes.

The NAICS codes contain maximums based on either the total number of employees in the company or the company's maximum annual receipts. For example, NAICS 238130 applies to framing contractors and has a size standard of \$14 million. To qualify as small, your company's receipts can't exceed this threshold. As another example, NAICS 335110 applies to electric lamp bulb and part manufacturing; the size limitation for this code is 1,000 employees.

A company with multiple business lines may satisfy different NAICS codes. It's possible that a company can qualify as small for some codes but not for others.

When the federal government reserves an acquisition for a small business, it includes the NAICS codes applicable to the needed service or supply. Businesses that satisfy the size standards then compete for the contract.

Contractors have misrepresented their size status during the bidding process. As described in a recent report to the US Congress, the VA inspector general found many cases where ineligible firms received contracts reserved for small businesses. Keep in mind that a false or misleading representation could lead to a fraud or false statement prosecution.<sup>4</sup>

To avoid prosecution, create a procedure that ensures your company accurately completes and updates certifications in the SAM database. Anticipate corporate changes that affect your company's certification. In the same vein, ensure your proposal teams correctly represent your company's status when responding to bids or proposals.

Your process must also detect illegal "pass-through" and "sham" transactions. These transactions enable a qualified small business to violate the requirements of the acquisition regulations by passing all or most of the contract responsibilities to a non-eligible firm. While subcontracting is permitted, the rules proscribe how much work the eligible firm must perform.<sup>5</sup>

### Subcontracting plans

Federal procurement regulations impose a number of subcontracting requirements on large businesses. The dollar size of the contract determines which rules apply.

Contractors that receive a contract exceeding the simplified acquisition threshold must try — to the maximum extent practicable — to offer subcontracting opportunities to small businesses, veteran-owned small businesses, service-disabled veteran-owned small businesses, HUBZone small businesses, small disadvantaged businesses and women-owned small businesses.

More requirements apply to contracts that exceed \$650,000 or \$1.5 million for construction. When contracts surpass these figures, the contractor can choose to satisfy the subcontracting requirement through either an individual or a commercial plan. An individual plan is specific to a contract, while a commercial plan applies to all commercial items sold by the company during the corporation's fiscal year.

Under a commercial plan, the contractor is covered for the entire fiscal year and doesn't have to submit plans for individual contracts. Depending on the corporation's structure, having one

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subcontracting plan may be easier to manage than multiple plans for specific contracts. A single plan also reduces the risk that the company won't meet its subcontracting goals.

The subcontracting plan contains goals for contracting with businesses that are small, veteran-owned, service-disabled veteran-owned, HUBZone, women-owned or that qualify as disadvantaged. Alaskan-native corporations and Indian tribes are included within the small or disadvantaged category. The plan must contain the total (in dollars) the company intends to subcontract.

The plan must also describe how the contractor will locate small businesses, and how those businesses can compete for contracts. Contractors must also file periodic reports with the government about subcontractor use.

Contractors are required to make good-faith efforts to meet the subcontracting plan's goals. While "good faith" is not defined, your program should have a written plan explaining how the company will meet the goals. In your program, specify the people within your company who will locate small businesses, and describe how your company will provide contracting opportunities to those small businesses. Be sure to name the person or organization within your company responsible for sending reports to the government.

Hold quarterly meetings with those executing the plan so you can spot

## Useful government contracting resources

- *National Contract Management Association (NCMA)* focuses extensively on government contracting and provides useful resources for contract managers.
- *American Bar Association Section of Public Contract Law* offers networking opportunities and provides materials discussing the legal aspects of government contracts.
- *Bloomberg BNA Federal Contracts Report* (a subscription service) offers daily updates on rules and cases that apply to government contracting.
- *Thompson Reuters* sells government contracting manuals, practice guides and regulations.
- *ESI International* offers basic and advanced government contracting courses.

## Helpful human trafficking resources

Government enforcement actions relating to human trafficking will likely rise given new regulations that apply to government contractors. Developing a human trafficking prevention program is a complex endeavor that requires the assistance of many corporate departments, such as finance, procurement and logistics. The following resources have useful information about human trafficking you can use when developing your policy:

- Electronic Industry Citizenship Coalition: [www.eicc.info](http://www.eicc.info)
- U.S. Department of State: [www.state.gov/j/tip](http://www.state.gov/j/tip)
- Polaris Project: [www.polarisproject.org](http://www.polarisproject.org)
- U.S. Department of Homeland Security: [www.dhs.gov/topic/human-trafficking](http://www.dhs.gov/topic/human-trafficking)
- Human Trafficking: [www.humantrafficking.org](http://www.humantrafficking.org) (Contains an extensive list of sites that discuss human trafficking.)

potential issues and have the time to make corrections.

Should a goal in the subcontracting plan remain unmet, the contracting officer must investigate to determine whether the contractor used good-faith efforts to meet the goal. This analysis is based on the totality of circumstances.

For example, if the government determines that the contractor did not make a good-faith effort to satisfy the plan, liquidated damages could be assessed. The regulations contain the method for determining the amount of liquidated damages the contractor may be required to pay.<sup>6</sup>

The government could also start suspension and debarment proceedings should it find the contractor

intentionally failed to achieve the plan's goals. The contractor could be found criminally liable if the company misrepresents the actual use of small businesses.

To avoid this pitfall, provide documentation describing all efforts used to subcontract with the companies identified in the plan. Written assertions that "good faith" was used are insufficient, and the government will likely disregard documents or electronic files written after the start of the good-faith inquiry.

### Gifts to government employees

Meals, entertainment and gifts have been part of the commercial sales culture for decades. Sales professionals use golf outings, meals, gift certificates

and tickets to sporting events as tools to maintain and develop business. Companies that sell or market to the government must be aware of the stringent rules governing gifts to federal employees.

Executive branch employees are prohibited from soliciting or accepting gifts from "prohibited" sources. A "prohibited" source includes someone who either conducts or is trying to conduct business with the employee's agency.<sup>7</sup> Gifts include meals, training and travel, as well as corporate marketing materials, such as coffee cups, thumb drives and shirts. In short: A gift is anything of value.

There are, of course, exceptions. Modest food and refreshments, such as coffee and donuts, are not gifts, nor are cards, certificates, plaques and other items that have little intrinsic value. Exceptions also include "rewards and prizes given to competitors in contests or events, including random drawings" open to the public.

Other gift exceptions often apply to government contractors; for example, an employee can accept free attendance at a "widely attended gathering," so long as the agency determines that attendance advances the agency's programs and operations. A widely attended gathering (WAG) is one where there are a number of people "with a diversity of views or interests" present. The WAG exception is important because, in addition to free attendance, a government employee can accept food, entertainment and materials provided to attendees. The employee cannot, however, accept gifts of travel or lodging in connection with the event.

Be sure to check if the government employee's agency has additional rules about accepting gifts. In some cases, an agency supplemental regulation may allow the employee to accept a gift that would otherwise be prohibited.

Under the 20/50 rule, a government employee can accept a gift that has an aggregate market value of \$20 or

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less. (Cash, including gift cards, are not permitted.) The employee cannot, however, accept more than \$50 in gifts from a prohibited source during the calendar year.

There is a mistaken belief that “source” means an individual who works for a prohibited source. This would mean that a government employee could accept a gift from each employee of the source without violating the gift rule. But to be clear: The annual cap applies to the source, which includes its officers and employees.

Violation of gift rules can have adverse consequences for the company, its employees and the government employee. Companies suspected of providing a gift that exceeds what the law permits could face an agency inspector general investigation. A broadly worded subpoena, which requires the production of all records related to any gift the company made to any member of the federal government, is also a possibility.

Gift transgressions may also lead to criminal bribery charges under 18 USC §201. Even if bribery isn’t charged, the government employee can be disciplined, and the company (and its employees) may be suspended or debarred from government contracting.

Some companies take a conservative approach and ban all gifts to

government employees, but, depending on your industry and business, such a policy may not be practicable. Assuming your company allows gifts, your compliance program should consist of written policies, training and tracking.

Most commercial companies have gift policies for commercial customers or suppliers. Your government gift policy could be included in that policy, or you could have a stand-alone policy, in which case, you should include a link to it in the commercial policy.

The WAG exception requires the government agency to analyze whether the employee’s attendance serves the agency’s interest. The government also examines the extent to which the source has interests the government employee could influence. The Office of Government Ethics issued a 15-page memorandum to agency ethics officials containing guidance about WAGs. Be sure to review this memorandum when drafting your policy.<sup>8</sup>

Give annual training to all employees who interact with the government. As part of the training process, it’s important to understand how new employees are added to training rosters. Take attendance and create a method for training those who did not attend.

The ability to track and account for what government employees receive

is critical to a successful compliance program. Without tracking, it’s nearly impossible to respond to a subpoena or government inquiry into alleged gift violations. So what should you track?

Track everything the company gives government employees. For example, coffee and donuts provided to a group of government employees should be recorded, even though those items are not gifts — you’ll want evidence to refute a claim by a competitor or a whistleblower that government employees received more than what the rule allows.

For gifts, track the name, title and agency of each gift recipient. Require a list of what was given, as well as the market value of the gift. Use a pre-approval method to make sure that a government employee does not exceed the 20/50 rule. In the event that a government employee receives more than \$50 in any calendar year, have your company invoice the employee for the value of the gift.

Describe this process in your policy and make sure your training includes a description of how the tracking system works.

### Human trafficking

Human trafficking, including abusive labor practices, has attracted considerable attention in light of recent media scrutiny. Commercial companies engaging in trafficking risk adverse publicity, boycotts and criminal penalties. And government contractors face even more risk.

All government solicitations and contracts include a clause prohibiting human trafficking. The clause, appearing as 52.222-50 (Combating Trafficking in Persons), bars contractors from “severe forms of trafficking in persons,” buying commercial sex acts and using forced labor.

The clause requires contractors to inform employees that the United States has a “zero tolerance” policy for human trafficking. Employees must also be told of the penalties for

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#### ACC EXTRAS ON... Government contracting

##### **ACC Docket**

Protecting Your Company’s Trade Secrets and Confidential Information in Government Contracting (Oct. 2009). [www.acc.com/docket/trade-sec\\_oct09](http://www.acc.com/docket/trade-sec_oct09)

##### **Top Tens**

Top Ten Things Every Government Contractor Should Know About Post-Government Employment and “Revolving Door” Restrictions (June 2013). [www.acc.com/top10/gov-con\\_jun13](http://www.acc.com/top10/gov-con_jun13)

Top Ten Things Every Government Contractor Should Know about the False Claims Act (Apr. 2013). [www.acc.com/top10/false-claim\\_aug13](http://www.acc.com/top10/false-claim_aug13)

##### **Presentation**

Best Practices for Managing Federal Funding and Government Contracting (Oct. 2012). [www.acc.com/bp-cont\\_oct12](http://www.acc.com/bp-cont_oct12)

##### **InfoPAK<sup>SM</sup>**

Building and Developing Compliance Programs: Preparing and Protecting Your Organization (Sep. 2012). [www.acc.com/infopak/compl-pro\\_sep12](http://www.acc.com/infopak/compl-pro_sep12)

ACC HAS MORE MATERIAL ON THIS SUBJECT ON OUR WEBSITE. VISIT [WWW.ACC.COM](http://WWW.ACC.COM), WHERE YOU CAN BROWSE OUR RESOURCES BY PRACTICE AREA OR SEARCH BY KEYWORD.

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violating the policy. In addition, the clause requires action against subcontractors engaging in trafficking, which means you must review your subcontracts to ensure you include anti-trafficking language.

Contractors also have reporting requirements. For example, a contractor must notify the contracting officer of “any information” the contractor receives that an “employee, subcontractor, or subcontractor employee” engaged in conduct prohibited by the policy. The notification must also include what actions the contractor took against the offending party.

If a contractor violates the clause, the government may remedy the situation through termination, as well as suspension and debarment. The government can even require the contractor to terminate a subcontract and remove offending employees from working on a contract.

Human trafficking is a problem that is pervasive in the supply chain; the risk that the company engages in or facilitates human trafficking rises when the company offshores work or services.

The human trafficking policy, as described in the FAR clause, contains little guidance about what activities constitute trafficking. For example, “severe forms of trafficking” is described as “[t]he recruitment, harboring, transportation, provision, or obtaining of a person for labor or services, through the use of force, fraud, or coercion for the purpose of subjection to involuntary servitude, peonage, debt bondage, or slavery.” The terms “force” or “coercion” are not defined, which creates challenges when crafting a compliance program to prevent these practices.

Some organizations offer useful guidance and materials you can use when developing a human trafficking program. For example, the Electronic Industry Citizenship Coalition (EICC), an association of electronic companies, established a code of conduct

and best practices to address areas of social responsibility. The coalition’s code contains principles and standards related to labor, which encompass the substance of the practices the FAR trafficking provisions try to eliminate.

EICC provides tools, such as a risk assessment, to use when building your company’s program. The US Department of State also has extensive materials for review when creating policies and training. Creating a program to deal with human trafficking is an extensive effort that requires coordination with the supply chain, human resources and purchasing, as well as your company’s overseas offices, where labor or supplies are purchased.

As with any compliance program, having policies isn’t enough. You will need an audit and verification process to ensure that your procedures are working. Your internal audit department can help with developing an audit mechanism.

The Obama Administration made the elimination and prevention of human trafficking a top priority. In September 2012, President Obama signed an executive order that requires the Federal Acquisition Regulatory Council to amend the FAR to include additional human trafficking requirements. Based on the language of the order, the council will likely create rules about recruiting and employment practices.

### The critical compliance program

Defaulting or breaching a government contract could affect your company’s ability to do business with the federal government. Failing to follow the terms of a government contract could also result in criminal liability for both the company and its employees. It’s imperative, therefore, that corporations have a strong compliance program to address the risks these contracts present. **ACC**

### NOTES

- 1 The FAR is found at 48 C.F.R. Title 48. There is a significant BAA exemption for information technology that qualifies as a “commercial item.” Information technology is defined as: “Any equipment, or interconnected system(s) or sub-system(s) of equipment, that is used in the automatic acquisition, storage, analysis, evaluation, manipulation, management, movement, control, display, switching, interchange, transmission, or reception of data or information by the agency.” 48 C.F.R. §2.101 (2013). The definition of “commercial item” is extensive, but can be summarized as one that is sold or offered for sale to the general public. If your product fits into this definition, then you are exempt from the BAA.
- 2 See FAR 48 C.F.R. §25.003 (2013).
- 3 *Anheuser-Busch Brewing Ass’n. v. United States*, 207 U.S. 556, 562, 28 S. Ct. 204, 52 L. Ed. 336, 43 Ct. Cl. 586, *Treas. Dec. 28778* (1908) (quoting *Jos. Schlitz Brewing Co. v. United States*, 181 U.S. 584, 21 S. Ct. 740, 45 L. Ed. 1013, 36 Ct. Cl. 580 (1901)).
- 4 New SBA rules, effective in July, provide enhanced penalties for false small business certifications. See [www.gpo.gov/fdsys/pkg/FR-2013-06-28/pdf/FR-2013-06-28.pdf](http://www.gpo.gov/fdsys/pkg/FR-2013-06-28/pdf/FR-2013-06-28.pdf).
- 5 See 48 C.F.R. §52.219-14 (2013) and 13 C.F.R. §125.6 (2013).
- 6 See 48 C.F.R. §19.705-7(f)(4) (2013).
- 7 A prohibited source also includes a person or organization that conducts activities regulated by the employee’s agency or “has interests that may be substantially affected” by the employee. See 5 C.F.R. §2635.203(d) (2013).
- 8 [www.oge.gov/OGE-Advisories/Legal-Advisories/DO-07-047--Widely-Attended-Gatherings/](http://www.oge.gov/OGE-Advisories/Legal-Advisories/DO-07-047--Widely-Attended-Gatherings/).

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