COVINGTON

COVINGTON & BURLING LLP

ADVISORY | Government Contracts & Financial Institutions

April 17, 2013

FINANCIAL INSTITUTIONS FACE NEW SUSPENSION AND DEBARMENT RISKS

Congress in recent years has responded to instances of government contractor misconduct by pressuring agencies to debar more contractors, and by enacting laws to make debarment easier. In fact, some lawmakers have favored making debarment automatic and mandatory.

After the bipartisan Commission on Wartime Contracting issued a scathing report on unpunished fraud and waste by contractors in Iraq and Afghanistan, Senator Claire McCaskill (D-MO)—now chair of the Senate Subcommittee on Financial & Contracting Oversight—proposed that contractors facing charges or allegations of crimes or contracting-related fraud be referred automatically to an agency suspending/debarring official.[1] Congress has even proposed to make debarment mandatory for seriously delinquent tax debts (as we discussed here). And the most draconian debarment measure came with the Consolidated Appropriations Act of 2012. Now, no 2012 appropriated funds (including those under continuing resolutions) may be utilized by the Department of Defense or other designated agencies to fund contracts for a corporation convicted of a felony during the previous two years—essentially, an automatic debarment.

The pressure on agencies to increase the number of discretionary suspensions and debarments also seems to be working. The number of such actions by one agency, the Department of Defense, increased last year by 37% (from 1,575 to 2,159), and a similar trend can be seen across the government. Never before have government contractors been as likely to face suspension or debarment.

What is more, the financial crisis has also placed financial institutions at increased risk. Because of the crisis, and the increasingly strident calls for financial institutions to be punished, the government may aggressively interpret the debarment regulations as including financial institutions within the definitions of "contractors" and "participants" in federal assistance programs. And the courts may support the government's position. Whether as part of advising the Department of Treasury in connection with the Troubled Asset Relief Program, underwriting secondary offerings of securities held by the federal government, or otherwise receiving federal money through contracts, grants, loans, or other agreements (whether or not related to the financial crisis), financial institutions are increasingly within the ambit of suspension and debarment.

These parallel developments, combined with the media and political attention elicited by the financial crisis, mean that financial institutions now face the same heightened risk of debarment as do entities that traditionally are viewed as government contractors. Concerned that financial institutions may have been inadequately punished, lawmakers may press agencies to exact punishment through their independent power to debar or suspend, or they may further push for automatic debarments.

---

[1] Although the January 2013 National Defense Authorization Act did not include Senator McCaskill's proposal, it still formalized and strengthened agencies' suspension and debarment powers (as we described at the time, here).

SUSPENSION AND DEBARMENT IMPLICATIONS

Administrative suspension and debarment are intended to be forward-leaning so as to protect the government, not to punish past misconduct. Still, many seek to use these sanctions to impose punishment. And as many government contractors will attest, regardless of the government's intent, the impact certainly feels punitive.

Suspension and debarment preclude firms that are not "presently responsible"[2] from engaging in government contracting and from participating in federal assistance programs throughout the federal government. Generally, the government may debar or suspend for the commission of any criminal offense relating to business integrity, for failure to perform or a history of poor performance of a government contract, or for "any other [serious or compelling] cause." The misconduct need not relate to a government contract, and in many instances it need not have been committed knowingly or willfully.

Suspension or debarment may also present potential public disclosure considerations for publicly-held entities if the consequences are, or may be, material from a financial point of view.

CONCLUSION

Financial institutions should view suspension and debarment as credible threats—and by analogy, so should other firms not typically seen as government contractors, such as those in the pharmaceutical industry in connection with the recent spate of Foreign Corrupt Practices Act prosecutions. If pressured by Congress, an agency might conclude that a financial institution that has been implicated in illegal or improper activities[3] has, at minimum, demonstrated a lack of business integrity or honesty sufficient to compromise the firm's status as "presently responsible" for suspension and debarment purposes.

The regulatory framework for suspension and debarment of financial institutions already applies; many such institutions utilize federal funds in procurement and/or nonprocurement forms. Further, to the extent that prosecutorial decisions regarding financial institutions may be influenced by a concern that, if successfully prosecuted, a financial institution might experience a serious run or even lose its charter, suspension or debarment might be seen as an alternative means by which the government may inflict punishment and reputational harm without such broad collateral damage.

Our experience tells us that a firm that is facing allegations of misconduct and that is cognizant of this risk should do three things. First, it should scrutinize its business to understand not only its susceptibility to suspension and debarment, but also the impact that either sanction would have on its core and ancillary businesses. For firms with few business connections to the federal government, the impact of suspension or debarment might appear to be marginal, but the collateral and reputational harm to the firm could still be substantial. Second, it should assess and, where

---

[2] A firm that has been determined to be "presently responsible" by a suspending/debarring official generally may not be suspended or debarred, regardless of the nature of the alleged misconduct. In essence, a firm is "presently responsible" if it had programs in place to mitigate the risk that misconduct would occur, and it responded appropriately to allegations of misconduct by improving its processes and implementing other remedial measures so as to assure the government that the misconduct would not reoccur.

[3] Similarly, a civil lawsuit brought by the Department of Justice ("DOJ") under the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") also increases the risk of suspension or debarment. Under FIRREA, DOJ can bring a civil lawsuit for violating certain criminal laws relating to financial fraud. As a matter of law, a civil judgment under FIRREA would be a sufficient basis to debar.

necessary, revise its processes relating to the alleged misconduct and its business conduct programs. Such a review would be useful in persuading the government that the firm is "presently responsible," and that debarment thus is not necessary.

Third, and finally, affected firms should attend to the advice we routinely give to government contractors that are accustomed to the threats of suspension and debarment. The most effective way to mitigate debarment risk is to proactively bring the matter to the attention of the relevant suspending/debarring official.[4] The firm should aim to demonstrate its present responsibility and convince the official that debarment is not necessary—a far more effective strategy than reacting with a belated response after a suspension or debarment has been imposed. Further, if a firm discovers misconduct that could potentially lead to suspension or debarment, the firm should engage outside counsel to advise on the risk, to assist in making appropriate disclosures, and to evaluate all legal and equitable arguments weighing against suspension or debarment, to include the mitigating factors recognized by the Federal Acquisition Regulation (such as improvements to ethics and compliance programs and internal processes). Effective representation by experienced counsel can help a firm avoid suspension or debarment, or respond to the potential for automatic debarment, even for a firm not typically seen as a government contractor.

If you have any questions concerning the material discussed in this client advisory, please contact the following members of our government contracts and financial institutions groups:

Steve Shaw	+1.202.662.5343	sshaw@cov.com
John Dugan	+1.202.662.5051	jdugan@cov.com
Bruce Bennett	+1.212.841.1060	bbennett@cov.com
Stuart Stock	+1.202.662.5384	sstock@cov.com
Jade Totman	+1.202.662.5556	jtotman@cov.com

[4] Many agencies, including the Department of Defense, have policies whereby firms that bring matters to their attention are not suspended or debarred, at least during the period in which the firm is demonstrating its present responsibility.