



FEDERAL CONTRACTS



REPORT

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Personal Conflicts of Interest: A New Area for Regulation

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Life for contractors providing systems engineering and technical assistance (SETA) has become much more challenging in recent months.

First, the rules regarding Organizational Conflict of Interest (OCI) are becoming more stringent. On the heels of GAO decisions that have raised the bar on OCI,¹ the Weapons System Acquisition Reform Act of 2009, Pub. L. No. 111-23, Section 207, contains new restrictions prohibiting contractors that have performed systems engineering and technical assistance from doing development or production work on the same program. Department of Defense Acquisition Regulation Supplement (DFAR) Case 2009-D015 (Organizational Conflicts of Interest in Major Defense Acquisition Programs) deals with this situation, and a proposed rule is expected to be announced soon.

Second, the Department of Defense (DOD) has underway a major insourcing initiative that will increase the defense acquisition workforce by 20,000 government employees, and decrease by 10,000 the number of contractors supporting the acquisition workforce.² Contractors are already seeing jobs moved on an individual basis from existing contracts to the government agencies they support.

Third, proposed rules dealing with contractor employee personal conflicts of interest (PCI) have been re-

leased and comments received.³ This analysis will focus on the PCI issues.

I. The Problem

Let's assume the following hypothetical case. You are CEO of Alpha Corporation, a company that regularly competes for contracts with a DOD agency. You are frustrated that Mega Corporation, a competitor, seems to get more than its share of business from the agency. In each debriefing, you learn that the ratings were close. In some instances you strive for a higher cost, technically superior approach, but Mega wins with a lower cost, technically acceptable proposal. So next time you adopt a low cost, technically acceptable strategy, but the agency decides that Mega's technically rich, more costly approach represents best value.

The agency's acquisition shop consists of 100 people. Twenty of them are government employees. The other eighty are contractor employees (but not Mega employees - we're keeping OCI out of this picture). Now here's the problem: unknown to you *and* unknown to the agency, many of the eighty contractor employees fall into one or more of the following categories: (a) they own stock in Mega, (b) they have close family members who own Mega stock, (c) they are involved in private investments and partnerships with Mega employees, (d) they have spouses, children and other close relatives who are employees of Mega, (e) they have received offers of employment from Mega, or (f) they have accepted free travel and other gifts from Mega.

You are increasingly suspicious that the contractor support personnel in the acquisition office may have divided loyalties. You learn that neither the agency nor Mega has any regulations or policies governing the con-

¹ See, e.g., *The Analysis Group, LLC*, B-401726; B-401726.2, November 13, 2009 (impaired objectivity protest sustained); *L-3 Services, Inc.*, B-400134.11; B-400134.12, September 3, 2009 (biased ground rules and unequal access to information protests sustained); *Nortel Government Solutions, Inc.*, B-299522.5; B-299522.6, December 30, 2008 (impaired objectivity protest sustained).

² 92 FCR 395.

³ 74 FR 58584. See also 93 FCR 25-27.

duct of contractor employees in relation to their work within government agencies. You press your case with agency officials, but they assure you that the contractor employees play only a technical support role. Agency officials emphasize that all of the supervisors, factor chiefs, panel chairs and advisory committee chairs, as well as the source selection authority, are government officials. The agency reminds you that these officials are seasoned professionals and alert to any tendency of bias or flaw in the information provided by contractor employees. You leave the meeting unconvinced. You begin to think about the subtle opportunities available to participants in the acquisition process, if their loyalties are divided, to shape the presentation of data and influence or even mislead selection officials.

II. The GAO Report

The hypothetical example set forth above is not based on an actual situation. Nevertheless, the issues dramatized here are based on findings in a March 2008 Government Accountability Office (GAO) Report to the Senate Committee on Armed Services, entitled *Defense Contracting: Additional Personal Conflict of Interest Safeguards Needed for Certain DOD Contractor Employees*.⁴

GAO found that significant numbers of defense contractor employees worked alongside DOD employees in the twenty-one DOD offices GAO reviewed. At fifteen of these offices, contractor employees not only outnumbered DOD employees but represented as much as eighty-eight percent of the workforce. GAO reported that the contractor employees performed key tasks, including developing contract requirements and advising on award fees for other contractors. While there are significant restrictions on federal employees, GAO found that few government ethics laws and DOD-wide policies are in place to prevent personal conflicts of interest for defense contractor employees. Of the laws in place, only the prohibition of bribery, kickback and other graft applies to DOD contractor employees as well as federal employees.

GAO said that activities that are regulated for federal employees but not their contractor employee co-workers include: (a) participating in a matter affecting personal financial interest, (b) avoiding appearance of partiality, (c) disclosure of financial interests, (d) acceptance of travel and gifts, (e) using nonpublic information for private gain, (f) future employment contacts, and (g) misusing position to provide preferential treatment to a private interest.⁵

GAO reported that some DOD offices and contractors had voluntarily adopted safeguards. In fact, the nine-

⁴ GAO-08-169 (March 2008).

⁵ The clause at FAR 52.203-13 now generally requires contractors to establish: (1) business ethics awareness and compliance programs, and (2) internal control programs. A contractor's business ethics awareness and compliance program must include "effective training programs" and the dissemination of information "appropriate to an individual's respective roles and responsibilities." FAR 52.203-13(c)(1)(i). Thus, even without separate regulatory coverage, contractors subject to the clause may already be under an obligation to provide training and guidance to employees working inside government agencies as to their responsibility to avoid personal conflicts of interest. Contractors would be well advised to review their business ethics awareness and compliance programs with the foregoing in mind.

teen DOD offices⁶ GAO reviewed that used contractor employees in the source selection process all had instituted safeguards such as contract clauses that prohibit contractor employees' participation in a DOD procurement affecting a personal financial interest. In other tasks, however, only three of the twenty-three defense contractors GAO reviewed had safeguards requiring employees to identify potential conflicts of interest. Government officials informed GAO they viewed current requirements as inadequate to prevent conflicts, especially financial conflicts of interest and impaired impartiality, from arising for certain contractor employees who are in a position to influence DOD decisions. Some program managers and defense contractor officials expressed concern over the costs of additional safeguards. Ethics officials and senior leaders, however, emphasized the need to counter the risks associated with personal conflicts of interest and the expanding roles of contractor employees.

III. The Proposed Regulation

Congress, in Section 841(a) of the DOD Authorization Act for Fiscal Year 2009, directed the Office of Federal Procurement Policy (OFPP) to develop a policy to prevent personal conflicts of interest by contractor employees performing acquisition functions for or on behalf of a federal agency or department.⁷ Congress also mandated development of a clause for inclusion in solicitations, contracts, task orders, and delivery orders. OFPP collaborated with the Federal Acquisition Regulation (FAR) councils to develop the proposed rule. That rule, issued November 13, 2009, includes a new FAR subpart 3.11, *Preventing Personal Conflicts of Interest for Contractor Employees Performing Acquisition Functions*, and a new FAR clause 52.203-16, *Preventing Personal Conflicts of Interest*.

This rule would place the burden on contractors to prevent personal conflicts of interest by their employees who perform agency acquisition functions "closely associated with" inherently governmental functions. Those contractors would be required to "identify and prevent personal conflicts of interest for such employees." The contractors would also be required to prohibit covered employees with access to "nonpublic government information" from using it for personal gain.

The rule includes a "remedies" clause authorizing "suspension of contract payments, loss of award fee, termination for cause, and suspension or debarment" if a contractor fails to comply with the requirement to prevent personal conflicts of interest. The rule would allow, in "exceptional circumstances," the heads of contracting activities to agree to a conflicts mitigation plan or waive the requirements. The rule illustrates "acquisition functions closely associated with inherently governmental functions" with the following examples:

- Planning acquisitions;
- Determining what supplies or services are to be acquired by the government, including developing statements of work;
- Developing or approving any contractual documents, including documents defining requirements, incentive plans, and evaluation criteria;

⁶ The GAO Report surveyed a total of twenty-one DOD offices. Of those twenty-one offices, nineteen used contractor employees in the source selection process.

⁷ Pub. L. No. 110-417.

- Evaluating contract proposals;
- Awarding government contracts;
- Administering contracts, including ordering changes or giving technical direction in contract performance or contract quantities, evaluating contractor performance, and accepting or rejecting contractor products or services;
- Terminating contracts; and
- Determining whether contract costs are reasonable, allocable, and allowable.

The rule would require contractors to have screening procedures in place to prevent potential personal conflicts of interest by affected employees. These screening procedures would include: (a) obtaining and maintaining a financial disclosure statement from each covered employee when the employee is initially assigned the task under the contract, (b) ensuring that covered employees update the disclosure statements annually, and (c) requiring covered employees to update the disclosure statement whenever their personal or financial circumstances change.⁸

In addition, the proposed rule would require contractors to:

- “prevent personal conflicts of interest, including not assigning or allowing a covered employee to perform any task under the contract if the contractor has identified a personal conflict of interest for the employee that the contractor or employee cannot satisfactorily prevent or mitigate in consultation with the contracting agency”;
- “prohibit use of non-public government information for personal gain”;
- “obtain a signed nondisclosure agreement to prohibit disclosure of non-public government information.”

Additionally, the rule would require contractors to inform covered employees of their obligation to:

- Disclose changes in personal or financial circumstances and prevent personal conflicts of interest;
- not use non-public government information for personal gain; and
- avoid even the appearance of personal conflicts of interest.

The proposed rule also sets forth contractor responsibilities for:

- maintaining effective oversight to verify compliance with personal conflict-of-interest safeguards;
- taking appropriate disciplinary action in the case of covered employees who fail to comply with the policies to prevent personal conflicts of interest; and
- providing the contracting officer with a report describing any personal conflict-of-interest violation by a covered employee when such violation is identified.

⁸ The requirement to collect and store such an extensive array of personal employee information raises a host of concerns. Apart from the additional security considerations required to respect and maintain privacy, there is the question of what response would be appropriate if and when government agencies demand production of the information. These issues will percolate as the implications of the proposed regulation manifest themselves. In the meantime, contractors will need to plan accordingly.

IV. Analysis

Commentators, including the American Bar Association (ABA) Section of Public Contract Law and the Council of Defense and Space Industry Association (CODSIA) have expressed concerns, including both the broad reach and lack of clarity in the proposed rule.⁹ There is no doubt that compliance with the rule would be expensive and intrusive. Contractors will need to collect, store and screen personal information from employees on a new and unaccustomed level. The rule may even place more obligations on contractor employees than currently exist for federal employees.

There is a serious question about the level of scrutiny of employee information that will be expected of contractors, particularly given the harsh remedies available to the government for noncompliance. As CODSIA pointed out, contractors in screening employees are dependent on the accuracy and completeness of the information provided by the employees themselves. For this reason, CODSIA has urged that contractors be allowed to rely in good faith on employee representations concerning their personal relationships and financial engagements.

Concerns over the proposed rule tend to fall into the following categories:

(a) lack of specificity regarding financial disclosure requirements and standards contractors must use in determining compliance,

(b) redundancy of remedies with existing remedies,

(c) absence of any demonstration why contractor employees should be held to the same (or higher) standard than what is mandated by statute for government employees,

(d) ambiguity in the definition of “acquisition functions closely associated with inherently governmental functions,”

(e) the need to ensure that covered contractor employees only include those acting on behalf of the government, and not on behalf of a contractor for evaluation by the government,

(f) whether it is appropriate for the term “covered employee” to include not only the contractor’s employees but also employees of subcontractors, consultants, and partners, as stated in the proposed rule, thus making the prime contractor responsible for screening not only its employees but all subcontractor personnel who are “covered employees” whether or not the employees are performing under a subcontract subject to the clause,

(g) vagueness in the eight service categories describing acquisition functions and omission of certain functions,

(h) the need to await further guidance from Office of Management and Budget (OMB) which is developing a definition of “inherently governmental functions” as required by section 321 of the FY 2009 Defense Authorization Act,

(i) omission of non-financial personal activities and relationships from the definition of PCI, and a need for further definition of “relationship”, and

(j) the need to delegate PCI waiver and mitigation authority to the contracting officer level, consistent with the approach used for OCIs.¹⁰

⁹ See 93 FCR 25-27.

¹⁰ See FAR 9.506.

The ABA Section of Public Contract Law pointed out the inconsistency in (a) requiring contractors to report PCI violations as soon as the violation is identified, but also (b) requiring “a description of the violation and the actions taken by the contractor in response to the violation.” The Section recommended that contractors be given a reasonable time to review the circumstances surrounding a suspected violation, especially in light of the potentially severe penalties that may be imposed on contractors. In this context, CODSIA suggested that responsibility for identifying PCI violations should be shared by the contractor, the employee and the government, and not placed on the contractor alone.

Also, the Section observed that the proposed rule does not define the scope of “relationships” that can trigger PCI concerns. For a model, the Section pointed to the Office of Government Ethics’ (OGE) Standards of Ethical Conduct for Executive Branch Employees (Standards of Ethical Conduct) in 5 C.F.R. Part 2635, which provide a definition of a “covered relationship” governing to Executive Branch employees. In particular, the Section noted that the OGE limits “imputed interests” of family members to the employee’s spouse and minor child and excludes other household members unless they qualify elsewhere within the definition (*e.g.*, business partners).¹¹

Because of the effort and cost associated with collecting and retaining financial disclosures for all covered employees, it is fair to ask whether some less intrusive and less costly approach might be justified in some instances. Accordingly, the Section suggested that alternatives might be suitable, and contractors should be given some discretion. Training and employee certifications could be effective for certain categories of employees, if not for all employees.

The proposed rule obligates contractors to prevent employees from using “non-public Government information” for personal gain, and the rule defines “non-public Government information” as “any information

that a covered employee gains by reason of work under a Government contract and that the covered employee knows, or reasonably should know, has not been made public.” But how does a contractor or its employees go about determining what information is “non-public Government information”? Rather than putting that burden on contractors and their employees, the Section suggested the possibility that “non-public government information” should be any information designated as such by the government agency.

Conclusion

Given the sensitivity of having contractor personnel working alongside government employees in government acquisition offices, the institution of personal conflict of interest safeguards will instill greater confidence in the integrity of the process. Greater protection will be afforded (a) the contractor employees who work inside government offices, (b) their government employee counterparts, (c) the agencies themselves, (d) the contractors who assign employees to work in the agencies, (e) the contractor competitors and other concerns whose proprietary information is reviewed by agency and contractor employees, and (f) the public at large.

Nevertheless, the combined effect of more stringent rules on OCI and PCI, along with the market-shrinking insourcing initiative, has put pressure on companies that sell equipment to the government but also have components that provide systems engineering and technical assistance to agencies. The greater degree of separation that will now be required between advisory work and sale of systems and equipment, combined with the new burden of collecting personal information from employees and screening them for personal conflicts of interest, has required these companies to rethink their strategy. The solution for some companies is to spin off their advisory services units. The remaining marketplace will be expanded for companies that provide high-level consultant services but do not supply hardware.

¹¹ See 5 C.F.R. § 2635.402(b)(2).