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San Diego might be one of the biggest small towns in the United States. And many of San Diego's busiest companies, whether small or large, comprise a local defense contracting community that operates like its own small town. Everybody seems to know everybody else. Much of the federal business that is developed and hiring that occurs in the San Diego region is the result of well-developed, personal relationships. Small-businesses owners, in particular, take advantage of personal relationships as a key first step in developing their companies.

This close-knit environment, more than anything else, necessitates that San Diego companies doing business in the federal contracting marketplace ready themselves for new personal conflict of interest (PCI) rules that many predict will be finalized by the end of this calendar year. This first wave of PCI rules will affect companies that provide acquisition support services, but the industry can expect future rules sets that will affect non-acquisition service providers as well.

In March 2008, Congress' General Accountability Office (GAO) issued an investigative report that warned lawmakers of a drastic need for new rules to prevent federal service contractors from continuing to accept contracts and task orders without addressing the PCIs of their employees. PCIs generally arise when a personal financial interest or personal relationship keeps an employee from performing his or her service contracting job impartially and in the best interest of the government agency customer.

A classic PCI example might involve a 20-something engineer working for a contractor that had been hired by the Navy to help develop ship repair work statements and perform other tasks in

support of Navy acquisition employees, and a 50-something owner of a local ship repair company — who also happens to be the parent of the engineer. GAO made clear in its March 2008 report that the integrity of federal service contracting system was at risk, because too many acquisition support contractors like the 20-something engineer in the example were performing contract work despite glaring PCIs.

GAO found that much of the increase in PCI activity was simply statistically unavoidable and due to the massive 78 percent increase in federal service contract spending between 1996 and 2008. Congress took action in the fall of 2009 and demanded as part of the Fiscal Year 2009 Defense Authorization Act that executive branch rule-makers begin the process of making changes to the Federal Acquisition Regulation (FAR), in the form of both policy statements and a standard contract clause, so that service contractors performing "acquisition functions closely related to inherently governmental functions" would prevent their employees from continuing to work despite PCIs. Proposed new FAR rules were published in November 2009, and the public comment period ended in January 2010. The PCI rules might not be finalized until shortly after a related federal policy is finalized to solidify the regulatory meaning of the phrase "inherently governmental functions."

If retained as currently proposed, the new FAR rules would apply to "covered employees" of prime contractors, subcontractors and other consultants performing acquisition-related services alongside government employees as part of contract or task order efforts exceeding \$100,000 in value.

The rules themselves impose an open-ended array of administrative and man-

agement requirements that could prove costly and burdensome to service contractors, and especially small businesses. Companies that perform contracts or task orders involving acquisition services will have to (1) develop a system for screening personal financial and relationship information for "covered employees," (2) ensure that current and future work assignments do not trigger employee PCIs, (3) require "covered employees" to sign non-disclosure agreements, and thereby promise not to use non-public government information for personal gain, (4) train and oversee employees to ensure updated PCI reporting is done on a rolling basis and (5) report failures to the government.

Contractors that fail to report employee compliance violations -- such as failing to report an employee that has not disclosed a PCI or employee use of non-public government information for personal gain -- can be made subject to a range of government remedies including suspension of payment, denial of award fees, termination of the contract or task order for default, disqualification from future service contract efforts and suspension or debarment from federal contracting.

Like the more commonly known OCI rules (also currently undergoing a major overhaul in Washington), the finalization of the proposed PCI rules will introduce yet another costly challenge into the everyday business of San Diego companies that perform acquisition services for federal agencies. Companies affected by the proposed rules would be wise to modify internal compliance policies and programs to address the requirements of these pending rules.

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