

CLIENT ALERT

Final Rule Governing Personal Conflicts of Interest of Contractor and Subcontractor Employees Supporting or Performing Certain Acquisition Functions

Nov.02.2011

On November 2, 2011, the government issued a final rule amending the Federal Acquisition Regulation ("FAR") to include new provisions governing personal conflicts of interest of contractor and subcontractor employees supporting or performing certain government acquisition functions.

Overview

Government employees, both military and civilian alike, are prohibited by federal law from having financial or other interests that conflict with their government duties. Acknowledging that certain work performed by government contractor employees could give rise to similar conflicts of interest, Section 841(a) of the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009, for the first time imposes personal conflict of interest ("PCI") restrictions on contractor personnel. These new rules are separate and apart from the organizational conflict of interest restrictions imposed on organizations under FAR Part 9.5

Effective November 2, 2011, the FAR Councils, in consultation with the Office of Federal Procurement Policy, issued a final rule concerning personal conflicts of interest. This rule imposes significant new and potentially burdensome compliance requirements on federal contractors and subcontractors that support or perform "acquisition functions closely associated with inherently governmental functions." Among other key features, the new rule:

- Adds to the FAR, for the first time, a definition of "personal conflict of interest" with a focus on whether financial interests, personal activities, or relationships could impair the employee's ability to act impartially and in the best interest of the government when performing under the contracts;
- Obligates federal contractors and subcontractors to inquire into the relationships, interests, and activities of certain "covered" employees to identify potential PCIs, before assignment of covered job duties to those covered employees;
- Requires contractors and subcontractors to manage and monitor the manner in which covered employees protect non-public information accessed during the performance of government contracts and subcontractors; and
- Establishes a new mandatory disclosure program to contracting officers for violations by employees and contractors, including belated identification of PCIs.

The effective date of the rule is December 2, 2011. Other than those for commercial items, which are exempt from the new rule, all contracts issued after this date will be subject to the new FAR PCI provisions, as will all task or delivery orders issued after December 2. Subcontracts over \$150,000 will also be covered.

Covered Contracts and Subcontracts

Only contract work for "acquisition functions closely associated with inherently governmental functions," which includes any work providing or *supporting* the provision of "advice or recommendations with regard to the following activities of a Federal

agency," are covered by the new rule. Examples include contracts where the contractor will be performing any of the following types of activities:

- 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, to include documents defining requirements, incentive plans, and evaluation criteria.
- Evaluating contract proposals;
- Awarding Government contracts;
- Administering contracts;
- Terminating contracts; and
- Determining whether contract costs are reasonable, allocable, and allowable.

FAR §§ 3.1101, 52.203-16(a).

The new FAR PCI clause at 52.203-16 is to be included by contracting officers in all covered contracts. Accordingly, it is important for contractors, when reviewing the solicitation – and certainly upon award – to recognize if the new PCI rules will apply, so that they can both (i) factor in the cost of compliance and (ii) establish internal systems necessary to comply with the rules.

Covered Employees

Only contractor and subcontractor employees performing "acquisition functions closely associated with inherently governmental functions" will be covered by the new PCI rules.

Contractors will need to devise a system to identify those personnel, prior to assigning them to covered tasks. These lists will need to be monitored and updated throughout the life of the covered contract or task or delivery order.

Covered Employees Must Disclose Personal Conflicts of Interest

The new FAR § 3.1101 defines a PCI as:

[A] situation in which a covered employee has a financial interest, personal activity, or relationship that could impair the employee's ability to act impartially and in the best interest of the Government when performing under the contract.

The provision notes that a *de minimis* interest that would not so impair the employee's ability to act impartially is not covered under the definition.

Sources of potential conflicts of interest may arise from:

- Financial interests of "close family members" and "household members," which will be imputed to the covered employee;

- Other employment or financial relationships, including seeking prospective employment or business;
- Gifts, including travel;
- Compensation, including wages, salaries, commissions, professional fees, or fees for business referrals;
- Consulting relationships (including commercial and professional consulting and service arrangements, scientific and technical advisory board memberships, or serving as an expert witness in litigation);
- Services provided in exchange for honorariums or travel expense reimbursements;
- Research funding or other forms of research support;
- Investment in the form of stock or bond ownership or partnership interest (excluding diversified mutual fund investments);
- Real estate investments;
- Patents, copyrights, and other intellectual property interests; or
- Business ownership and investment interests.

Thus, contractors subject to this new rule will need to prepare disclosure forms for covered employees to disclose the existence of personal conflicts. Because such disclosures will likely contain sensitive financial and other information – relating not only to the employee, but also to family members or household members – employees may be concerned.

Apart from the training obligations for covered employees, contractors should also consider developing a training program and protocol for anyone who will be reviewing the disclosure forms to identify potential conflicts. Some companies might decide to contract out the review process to lessen employee concerns about the compromise of personal data. These records must be maintained in accordance with the FAR record retention requirements.

Covered Employees with PCIs Cannot Be Assigned to Perform these Tasks, unless the Conflict is Mitigated or Waived

Although the clear preference in the rule is for avoidance of conflicts (*e.g.*, not assigning an employee with a conflict to the contract or task order), the new FAR provision establishes options for mitigation and waiver of PCIs in "exceptional circumstances." The contractor may propose mitigation measures which reduce or fully neutralize the harm created by the PCI. The agency may accept mitigation upon approval by the Head of Contracting Activity ("HCA"). Alternatively, the contracting officer may seek HCA approval of a waiver of the requirement to avoid PCIs. The approval of the HCA is non-delegable.

Covered Employees Required to Sign Non-Disclosure Agreements

Contractors must also require covered employees to sign non-disclosure agreements that prohibit them from using for personal gain nonpublic information accessed through performance of the contract work. The new FAR rule does not contain a sample or template of an acceptable NDA, and so contractors will be required to provide their own. These records must also be maintained in accordance with the FAR record retention requirements.

Contractors Required to Disclose Employee Violations

As part of their new oversight obligations, contractors must report to the contracting officer any PCI violation by a covered employee as soon as it is identified. The disclosure should include relevant facts describing the violation and the proposed corrective actions to be taken by the contractor in response to the violation. The rule notes that follow-up reports on corrective

action may be necessary and, if the agency is unsatisfied with the corrective action efforts, appropriate legal action may be taken.

Appearance of a Personal Conflict

Perhaps one of the most controversial provisions of the new regulation dealing with PCIs is the requirement that employees be trained to avoid any "appearance" of having a PCI. While the only mention of the concept "appearance" of PCIs is contained within the training provision at FAR 3.1103(a)(3), the fact that it is mentioned at all suggests that a doctrine analogous to the "appearance of impropriety" doctrine in the organizational conflict of interest ("OCI") context found in FAR Part 9.5 or in the executive branch standards of conduct rules found I 5 CFR 2635 also can arise in the PCI context. What constitutes an "appearance" of a PCI – as opposed to an actual PCI – and what contractors must do to avoid and disclose these "appearances" is an open question currently undefined in the rule.

Mandatory Employee Training

The FAR requires contractors to inform covered employees about their obligations to disclose and prevent PCIs, not to use nonpublic information, and to avoid even the appearance of impropriety.

Employee Discipline

When oversight efforts identify an employee who has violated his or her obligations to avoid PCIs and/or disclose relevant PCI information, the contractor must take appropriate disciplinary actions to highlight the seriousness of the obligations. No specifics are provided as to what types of discipline are appropriate.

Subcontract Flowdown Obligation

The new clause specifies that the contractor must include the entirety of the clause in any non-commercial item subcontract over \$150,000 in which the subcontractor employees will perform "acquisition functions closely associated with inherently governmental functions."

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