

DOD Issues Proposed Rule to Address Conflicts of Interest for Certain Consulting Services

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Last week, the U.S. Department of Defense (DOD) published a proposed rule that would amend the Defense Federal Acquisition Regulation Supplement (DFARS) to implement a statutory prohibition on DOD awarding contracts with NAICS codes beginning with 5416 – which includes certain management, scientific, and technical consulting services – to offerors that also perform consulting services for certain foreign entities related to the governments of China, Russia, and other countries of concern, unless the offeror has an approved conflict-of-interest mitigation plan. Comments on the proposed rule are due by November 25, 2024.

When the proposed rule becomes final, federal contractors providing consulting services to DOD will need to assess whether they, along with any subsidiaries or affiliates, provide consulting services to covered entities and, if so, implement mitigation plans that must be approved by the contracting officer and may be audited by other government entities. Furthermore, under this proposed rule, DOD anticipates that many covered contractors will be those that perform work on contracts below the simplified acquisition threshold, or that provide commercial services.

Background

The National Defense Authorization Act (NDAA) for Fiscal Year 2024 sought to prevent conflicts of interest that might arise when entities seeking to provide consulting services to DOD also provide consulting services to certain foreign entities, including the People's Republic of China, the Russian Federation, other governments determined to have

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repeatedly provided support for acts of international terrorism, and entities on certain U.S. Department of Commerce, U.S. Department of State, and Office of Foreign Assets Control lists. To address potential national security risks when contractors support both the U.S. Government and covered foreign entities, Congress enacted Section 812 of the NDAA, which prohibits DOD from entering into a contract with an entity that provides consulting services and is assigned a NAICS code starting with 5416, if that entity is unable to certify that (i) neither the entity, nor any subsidiaries or affiliates, hold a contract for consulting services with a covered foreign entity, or (ii) the entity maintains an auditable conflict-of-interest mitigation plan. The NDAA directed DOD to issue implementing regulations no later than 180 days after the NDAA's December 22, 2023 enactment (June 19, 2024).

The NDAA requires that, to be approved by a contracting officer, a conflict-of-interest mitigation plan must:

- Identify covered contracts with a covered foreign entity;
- Include a written analysis, including a course of action for avoiding, neutralizing, or mitigating the actual or potential conflict of interest of such a covered contract with DOD;
- Describe the procedures adopted by an entity to ensure that individuals who will be performing a covered contract will not, for the duration of such contract, also provide any consulting services to any covered foreign entity; and
- Describe the procedures by which an entity will submit to the contract oversight entities a notice of an unmitigated conflict of interest with respect to a covered contract within 15 days of determining that such a conflict has arisen.

The NDAA provides that a waiver may be sought and approved by the Secretary of Defense or a Senate-confirmed designee. Any waivers must be reported to Congress.

On September 19, 2024, GAO released a report, "Timely Actions Needed to Address Risks Posed by Consultants Working for China," documenting GAO's assessment of the national security risks posed when contractors consult for both the U.S. and Chinese governments. GAO determined that current acquisition regulations do not specifically direct agencies to consider whether contractors consulting for the U.S. Government also have consulting contracts with China and recommended that DOD take steps to ensure the DFARS is updated to incorporate the direction of NDAA Section 812. In estimating the impact of this recommendation, GAO noted that of that \$233.4 billion DOD obligated for contracts associated with consulting services in fiscal years 2019 through 2023, \$21.3 billion was for contracts with entities assigned a NAICS code beginning with 5416 (just under 10%). DOD responded to GAO's report confirming that rulemaking to implement Section 812 was in progress.

Summary of the Proposed Rule

On September 26, 2024, DOD issued a proposed rule to implement Section 812. The proposed rule adds a new section to the DFARS, 209.57X, Conflicts of Interest in Certain Consulting Services. DFARS 209.57X(c) would prohibit contracting officers from awarding contracts assigned a NAICS code beginning with 5416 to an offeror that holds a contract for consulting services with one or more covered foreign entities if the offeror

does not have an approved conflict-of-interest mitigation plan. The proposed rule also included a new solicitation provision at DFARS 252.209-70XX, Prohibition Relating to Conflicts of Interest in Consulting Services—Certification, for use in solicitations assigned a NAICS code beginning with 5416 that involve consulting services. Under the proposed rule, offerors responding to solicitations assigned those NAICS codes will be required to certify whether they, or an affiliate or subsidiary, hold contracts that involve consulting services with one or more covered foreign entities and whether they maintain a conflict-of-interest mitigation plan. If the offeror cannot complete that certification, the offeror may contact the contracting officer for guidance on submitting a conflict-of-interest mitigation plan. If the offeror's plan is approved, the contracting officer will incorporate the plan into the resulting contract.

The proposed rule includes definitions for several key terms, including:

- *Consulting services* means advisory and assistance services, excluding those related to compliance with legal, audit, accounting, tax, reporting, or other requirements of the laws and standards of countries; or participation in a judicial, legal, or equitable dispute resolution proceeding.
- *Covered contract* means a DOD contract involving consulting services.
- *Covered foreign entity* includes the governments of the People's Republic of China, the Russian Federation, and others determined to have repeatedly provided support for acts of international terrorism; and entities on certain Commerce, State, and OFAC lists (for example, the Entity List, Denied Persons List, Military End User List, and Non-Specially Designated Nationals Chinese Military- Industrial Complex Companies List).

Although the proposed rule does not define "affiliates" or "subsidiaries," Section 812 of the NDAA applied the existing definitions at FAR 2.101. FAR 2.101 defines *affiliates* as associated business concerns or individuals if, directly or indirectly either one controls or can control the other; or a third party controls or can control both. This FAR section also references FAR 9.403, however, which includes an additional definition for "indicia of control." The text of the proposed rule is ambiguous as to whether it also incorporates the indicia of control for affiliation in FAR 9.403.

DOD has determined that the proposed provisions would apply to acquisitions below the simplified acquisition threshold (SAT), and to acquisitions of commercial services under FAR Part 12. The provisions would not apply to acquisitions of commercial products. DOD estimates that it will receive 5,307 certification responses from contractors annually and 177 conflict-of-interest mitigation plans.

Considerations for Contractors

The spotlight returns to FOCI mitigation. As noted in GAO's report, Congress perceives that national security risks are presented when companies consult for both the U.S. Government and potential U.S. adversaries. Previously, the impacts of foreign ownership, control, or influence (FOCI), and whether a contractor needed a FOCI mitigation plan, were evaluated primarily for federal contractors that access classified information. DOD updated its FOCI Instruction this past summer to expand the FOCI review process to include existing or prospective DOD contractors or subcontractors on a contract, subcontract, or defense research assistance

award with a value exceeding \$5 million. Through Section 812 of the FY2024 NDAA, Congress made clear that it is concerned about potential national security risks in other areas and whether a contractor can provide impartial assistance or advice to the U.S. Government. It directed DOD to analyze those risks through the organizational conflict of interest framework that many contractors are already familiar with.

Defining corporate relationships. Unlike most government contracts certifications, the certification in the proposed rule would not be limited to the offeror, but it would also include subsidiaries and affiliates. The proposed rule's reliance on the FAR definition for affiliates, which is broad, could create difficulty for contractors – especially smaller business concerns – to feel confident that they have accurately responded to the required certification. The definition for affiliates and subsidiaries is an area in which DOD could provide more clarity to industry in the final rule.

Mitigation plans. Aside from repeating the language in the NDAA, the proposed rule does not provide any other detail on what conflict-of-interest mitigation plans should include. To help contractors prepare these plans, DOD should consider clarifying how contracting officers will evaluate and approve these plans. Again mirroring the NDAA language, the proposed rule requires that plans must be auditable by certain government entities such as the contracting officer, DCMA, and the Office of Inspector General, but it is unclear whether such audits are required or how often they would be conducted.

What about later-obtained contracts? The prohibition in the proposed rule would not allow DOD contracting officers to award a covered contract to an offeror that presently holds a contract for consulting services with a covered foreign entity and does not have a mitigation plan in place. The rule does not address whether a contractor has an obligation to update or change its certification if it later obtains a contract to provide consulting services to a covered foreign entity. Of course, any certifications related to new solicitations or proposals would have to address the new foreign relationships.

These are areas that Wiley will continue to monitor throughout the rulemaking process.