

ALERT

# FAR Councils Issue Final Rule Aimed at Preventing Contractor Employee Personal Conflicts of Interest

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November 3, 2011

On November 2, 2011, the Civilian Agency Acquisition Council and the Defense Acquisition Regulations Council (FAR Councils) issued a final rule on "Personal Conflicts of Interest," or "PCIs," that will place significant new obligations on contractors and contractor employees. 76 Fed. Reg. 68,017 (Nov. 2, 2011). The rule requires contractors that have employees performing "acquisition functions closely associated with inherently governmental functions" to identify and prevent PCIs for such employees. It also requires such contractors to prohibit "covered employees" with access to non-public Government information from using it for personal gain. The final rule implements section 841(a) of the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009, Pub. L. No. 110-417, and follows a proposed rule issued nearly two years ago, 74 Fed. Reg. 58,584 (Nov. 13, 2009).

The final rule, which includes only minor revisions from the proposed rule, creates a new subpart under FAR part 3 (FAR subpart 3.11), as well as a new clause for Contracting Officers (COs) to use in contracts (FAR 52.203-16). The rule's effective date is December 2, 2011. The new clause will be included in all covered contracts and task or delivery orders issued on or after the effective date. COs are instructed to modify, on a bilateral basis, existing task- or delivery-order contracts to include the new clause for future orders. In the event that a contractor refuses to accept such a modification, the contractor will not be eligible to receive further orders under the contract.

## Practice Areas

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Ethics Advice & Compliance Audits and Plans  
Government Contracts

## Definition of Key Terms

The final rule defines four key terms that are critical to the new PCI policy:

- "Acquisition function closely associated with inherently governmental functions" is defined as supporting or providing advice or recommendations to a federal agency regarding a number of activities, including planning acquisitions, determining what supplies or services are to be acquired by the government, developing or approving contractual documents, evaluating contract proposals, awarding, administering or terminating government contracts and determining whether contract costs are reasonable, allocable and allowable.
- "Covered employee" is defined as an individual who performs an acquisition function closely associated with inherently governmental functions. The definition in the final rule was modified to clarify that contractors are not directly responsible for the employees of their subcontractors. However, the rule requires that the new clause at 52.203-16 be flowed down to subcontractors, resulting in indirect responsibility.
- "Non-public government information" is defined as any Government or third-party information that (1) is exempt from disclosure under a statute, regulation or Executive Order (including the Freedom of Information Act), or (2) has not been disseminated to the general public and the Government has not yet determined whether the information can or will be made available to the public.
- "Personal conflict of interest" is defined broadly 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. *De minimis* interests that would not "impair the employee's ability to act impartially and in the best interest of the Government" are excluded. The rule explains that among the sources of PCIs are (1) financial interests of the covered employee, close family members or other members of the household, (2) other employment or financial relationships, including seeking or negotiating for prospective employment or business and (3) gifts, including travel. The rule also includes a list of eight specific examples of activities in which financial interests may arise.

## New Obligations for Contractors

Significantly, the FAR Councils declined requests to simply extend to contractor employees the ethics rules that apply to Government personnel. The Councils appropriately recognized that "most of the ethics statutes that apply to Government employees are not applicable to contractor employees." Nevertheless, the rule places several significant obligations on contractors performing acquisition functions closely associated with inherently Government functions, including:

1. Having procedures in place to screen covered employees for potential PCIs, including obtaining financial disclosure statements from each covered employee when he or she is initially assigned to the contract and updating that disclosure statement whenever the employee's personal or financial circumstances change in such a way that a new PCI might occur because of the task the covered

employee is performing;

2. Not allowing a covered employee to perform tasks for which they have identified a PCI for that employee that the contractor cannot satisfactorily prevent or mitigate in consultation with the contracting agency, prohibiting the use non-public government information for personal gain, and obtaining a signed non-disclosure agreement to prohibit disclosure of non-public government information;
3. Informing covered employees of their obligation to disclose and prevent PCIs, not to use non-public government information for personal gain, and to avoid even the appearance of PCIs;
4. Maintaining effective oversight to verify compliance with PCI safeguards;
5. Taking appropriate disciplinary action in the case of covered employees who fail to comply with PCI policies; and
6. Reporting any PCI violations by a covered employee to the CO as soon as identified, including a description of the violation and the proposed actions to be taken by the contractor in response to the violation, with follow-up reports of corrective actions taken, as necessary. Notably, the FAR Councils rejected a recommendation that reports be made to the Inspector General, recognizing that "[n]ot all employee [PCI] violations are violations of criminal law or nefarious."

### **Implementation of the New PCI Policy**

The rule provides that, if a contractor reports a PCI violation to the CO, the CO is required to review the actions taken by the contractor, determine whether any action taken by the contractor has resolved the violation satisfactorily and take any other appropriate action in consultation with agency legal counsel.

In "exceptional circumstances," if a contractor cannot satisfactorily prevent a PCI, the rule allows a contractor to submit a request through the CO for the head of the contracting activity (HCA) to agree to a plan to mitigate or waive the PCI. If the HCA determines in writing that such action is in the best interest of the Government, he or she may impose conditions that provide mitigation of a PCI or grant a waiver.

The proposed rule included several "remedies" in the event the CO determines there is sufficient evidence of a violation, including suspending contract payments, loss of award fee, termination for cause, and suspension or debarment. The FAR Councils removed the list of remedies from the final rule because "the FAR contains adequate remedies to address non-compliance with any material requirement of a contract" and the PCI rule "was not intended to create new remedies."

The final rule makes clear that contractors only face liability for failing to comply with their obligations discussed above. Contractors are not themselves liable for PCI violations by employees unless the violation can be attributed to a failure of oversight by the contractor under the new clause.

Under the rule, the new PCI clause, FAR 52.203-16, Preventing Personal Conflicts of Interest, will be inserted into solicitations and contracts that exceed the simplified acquisition threshold and are for services that involve performance of acquisition functions closely associated with inherently governmental functions for or

on behalf of a federal agency or department. If only a portion of a contract involves the performance of those services, the CO is required to limit the applicability of the clause to that portion of the contract that is for the performance of those services. The rule requires prime contractors to include the substance of the clause in all subcontracts over \$150,000 that will involve the performance of those functions.

The final rule also amends FAR Part 12 to clarify that the PCI policy does not apply to contracts for the acquisition of commercial items.

Finally, in a separate Request for Information issued on November 2, the FAR Councils requested public comment on the question of whether additional guidance is necessary to address PCIs by contractor employees, including whether the PCI coverage in the new rule should be expanded to cover contractor employees beyond those performing acquisition functions closely associated with inherently governmental functions. Comments are due on or before January 3, 2012.