



*Compliance Standards for Government Contractor Employee Personal Conflicts of Interest and Use of Confidential Information*

**Preamble**

The Conference recommends that the Federal Acquisition Regulatory Council publish a set of contract clauses in the Federal Acquisition Regulation (“FAR”) that agency contracting officers could integrate into contracts posing particular risks of government contractor employee personal conflicts of interest or misuse of confidential information. In order to ensure that this system protects the public interest but does not create excessive compliance costs for contractors or monitoring costs for agencies, these clauses should apply only to contractor employees who perform certain activities identified as posing a high risk of personal conflicts of interest or misuse of confidential information.

*Background*

In recent years, the federal government has increasingly relied upon private contractors to perform services previously provided in-house by government employees. Despite this expansion in the use of government contractors, there is a substantial disparity between the ethics rules regulating government employees and those applicable to government contractor employees. Whereas an array of statutes and regulations creates an extensive ethics regime for government employees, the rules currently applicable to contractor employees vary significantly by agency.

Government employees are subject to various statutes and regulations that create a comprehensive ethics regime governing, amongst other things, their financial interests, use of government resources, outside activities, and employment options after leaving government.<sup>1</sup> By contrast, the compliance standards applicable to contractor employees are much less comprehensive and can vary significantly from contract to contract. A handful of statutes apply to contractor employees and prohibit their offering bribes or illegal gratuities,<sup>2</sup> serving as a foreign agent,<sup>3</sup> disclosing sensitive procurement information,<sup>4</sup> or offering or receiving kickbacks.<sup>5</sup> The FAR requires contracting officers to identify organizational conflicts of interest (in which the contractor has a company interest that may bias its judgment or the advice it

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<sup>1</sup> Kathleen Clark, *Ethics for an Outsourced Government* 7 (forthcoming), available at <http://www.acus.gov/research/the-conference-current-projects/government-contractor-ethics/>.

<sup>2</sup> 18 U.S.C. §§ 201(b)–(c).

<sup>3</sup> *Id.* § 219.

<sup>4</sup> 41 U.S.C. § 2102.

<sup>5</sup> *Id.* §§ 8701–07 (prohibiting kickbacks to contractors, subcontractors, and their employees).



provides to the government) and either address or waive such conflicts.<sup>6</sup> The FAR also requires that contracting firms that have entered one or more government contracts valued in excess of \$5 million and requiring 120 days or more to perform have in place “codes of business ethics and conduct.”<sup>7</sup> A handful of agencies have adopted ethics regulations supplementing the FAR,<sup>8</sup> and still other agencies impose additional regulations by contract clause.<sup>9</sup>

Finally, certain contracting firms, most notably some performing work for the Department of Defense, have voluntarily adopted internal ethics codes, some of which provide fairly detailed rules relating to personal conflicts of interest, confidentiality, gifts and gratuities, protection of government property, and other major ethical areas as well as internal discipline for employee violations of such codes.<sup>10</sup> Nevertheless, the company codes do not generally require that unethical conduct that is not otherwise illegal or unlawful be reported to the contracting agency,<sup>11</sup> and many contractors (particularly small businesses) do not have such internal ethics codes.

### *Scope of the Problem*

In short, a significant disparity exists between the ethical standards applicable to government employees, which are comprehensive and consist predominantly of specific rules, and those applicable to contractor employees, which are largely developed and applied on an ad

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<sup>6</sup> 48 C.F.R. § 9.500 *et seq.* The FAR provision applies only to organizational conflicts of interests, wherein the *firm itself* possesses such business interests, and not to personal conflicts of interest, wherein one of the *firm’s employees* has a business or financial interest that could influence his or her decisionmaking in performing a contract.

<sup>7</sup> *Id.* §§ 3.1000–04. These codes must ensure that the firm has adequate systems for detecting, preventing, and reporting illegal conduct and violations of the civil False Claims Act and that it “[o]therwise promote[s] an organizational culture that encourages ethical conduct.” *Id.* § 52.203-13. The FAR does not dictate, however, what ethical misconduct the company internal codes must address.

<sup>8</sup> Agencies that have adopted ethics regimes supplementing those contained in the FAR include the Department of Energy, Environmental Protection Agency, Department of Health and Human Services, Nuclear Regulatory Commission, Department of Treasury, and United States Agency for International Development. Kathleen Clark, *Ethics for an Outsourced Government* Appendix 5. The Federal Deposit Insurance Corporation, though it is not covered by the FAR, has implemented a particularly extensive ethics system for its contractor employees. *Id.*; *see also* 12 C.F.R. § 366.0 *et seq.*

<sup>9</sup> *See, e.g.*, USAID Acquisition Regulation 148, *available at* <http://www.usaid.gov/policy/ads/300/aidar.pdf>.

<sup>10</sup> *See generally* DEF. INDUS. INITIATIVE ON BUS. ETHICS & CONDUCT, PUBLIC ACCOUNTABILITY REPORT (2009), *available at* <http://www.dii.org/files/annual-report-2008.pdf>. Many of the most extensive internal codes are implemented by companies who are members of the Defense Industry Initiative (“DII”), which includes 85 top defense contractors who agree to implement such ethics codes and comply with certain values in maintaining an ethical workplace. Contractor employees can be disciplined internally for violating their company’s ethics code, and companies commit to disclose violations of the law and “instances of significant employee misconduct” to the contracting agency. *Id.* at 49.

<sup>11</sup> *See id.* at 49–50 (contractors are only *required* to report those violations covered by FAR § 52.203-13).



hoc basis and involve significantly vaguer standards. Of course, the mere existence of a disparity is not itself conclusive evidence that contractor employee ethics standards should be expanded. Indeed, simply applying the rules governing the ethics of government employees (particularly those dealing with financial disclosures to guard against personal conflicts of interest) directly to contractors would likely create excessive and unnecessary compliance costs for contractors and monitoring costs for agencies.<sup>12</sup> Thus, the Conference has sought to identify the most significant ethical risks that arise in government contracts as well as the activities most likely to implicate those risks.

*Personal Conflicts of Interest and Misuse of Confidential Information*

The most common ethical risks addressed in specific supplements to the FAR (as well as in contractors' own internal codes of conduct) include personal conflicts of interest, gifts, misuse of government property, and misuse of confidential information.<sup>13</sup> Of these major ethical risks, existing criminal laws are largely sufficient to regulate contractor offering or receipt of gifts and misuse of government property. With respect to gifts, criminal bribery laws would prohibit a contractor employee's *offering* anything of value to a federal employee to obtain favorable treatment,<sup>14</sup> and the Anti-Kickback Act would prohibit a contractor employee from *accepting* any gift from a potential sub-contractor or any other party seeking favorable treatment under the contract.<sup>15</sup> With respect to misuse of property, traditional criminal laws against larceny and embezzlement would prohibit a contractor employee's misappropriating public property, and federal criminal law prohibits a contractor employee's misusing or abusing government property.<sup>16</sup>

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<sup>12</sup> REPORT OF THE ACQUISITION ADVISORY PANEL 418 (Jan. 2007). Of course, various agencies have extended certain aspects of the ethics standards applicable to government employees to contractor employees, *see, e.g.*, 12 C.F.R. § 366.0 *et seq.* (FDIC contractor regulations), and their decision to do so does not necessarily create excessive compliance or monitoring costs. Nevertheless, extending *all* government employee ethics rules to *all* contractor employees throughout the executive branch would likely create excessive costs, and the FAR and individual agencies should exercise caution in ensuring that any expansion of the current regime is cost-effective.

<sup>13</sup> *See id.*; Kathleen Clark, *Ethics for an Outsourced Government* Appendix 5; Marilyn Glynn, *Public Integrity & the Multi-Sector Workforce*, 52 WAYNE L. REV. 1433, 1436–38 (2006); DEF. INDUS. INITIATIVE ON BUS. ETHICS & CONDUCT, *supra* note 10, at 29–60.

<sup>14</sup> 18 U.S.C. § 201(c).

<sup>15</sup> 41 U.S.C. § 8702. Of course, in light of the severity of criminal sanctions, many instances of misconduct are likely to go unpunished under the current regime. For instance, the United States Attorney's Office is probably unlikely to prosecute a contractor for accepting a lavish meal from a prospective sub-contractor. Nevertheless, the mere threat of criminal prosecution is likely to deter a great deal of potential misconduct.

<sup>16</sup> 18 U.S.C. § 641; *Morissette v. United States*, 342 U.S. 246, 272 (1952). In addition, agencies typically stipulate that government property may not be used for personal benefit (*e.g.*, a contractor employee's using government computers for personal use) by contract clause. Glynn, *supra* note 13, at 1437.



On the other hand, a contractor employee's acting despite a personal conflict of interest or exploiting confidential information for personal gain is less likely to be punishable under existing laws. Though the Anti-Kickback Act would prevent a contractor employee's directing business to a third party in exchange for an actual payment,<sup>17</sup> nothing under current law would prevent a contractor employee from directing business towards a company in which he or she owns stock (*i.e.*, a personal conflict of interest). Though insider trading laws would prevent a contractor employee's buying securities based upon information learned from government contracts,<sup>18</sup> nothing under current law would prevent a contractor from purchasing other items, such as land that will appreciate upon announcement of construction of a military base, on the basis of information learned while performing its contractual duties.

In this light, various governmental entities that have studied issues of contractor ethics have singled out personal conflicts of interest and misuse of confidential information as areas calling for greater oversight.<sup>19</sup> Of course, any effort to extend ethics standards in these areas must be sensitive to the compliance costs that will be created for contractors (which generally will be passed on to the government) and the monitoring costs that will be created for agencies.<sup>20</sup> Thus, ethics rules should not be extended to contractors who pose essentially no risk of ethical violations. For instance, a contractor employee who enters information from paper forms into a computer likely poses little risk of developing a personal conflict of interest. As such, the Conference's recommendations focus solely on contracts for particular types of activities (and

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<sup>17</sup> 41 U.S.C. § 8702.

<sup>18</sup> *Dirks v. Sec. Exch. Comm'n*, 463 U.S. 646, 655 n.14 (1983); 17 C.F.R. 240.10b5-2(b).

<sup>19</sup> *See, e.g.*, Preventing Personal Conflicts of Interest for Contractor Employees Performing Acquisition Functions, 74 Fed. Reg. 58,584, 58,588–89 (proposed Nov. 13, 2009) (setting forth rules regulating personal conflicts of interest and use of confidential information for private gain in the case of contractors performing acquisition activities closely related to inherently governmental functions); Glynn, *supra* note 13, at 1436–37 (article by general counsel of the Office of Government Ethics recommending, inter alia, extending ethics rules to include contractor employee conflicts of interest and misuse of confidential information); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-169, ADDITIONAL PERSONAL CONFLICT OF INTEREST SAFEGUARDS NEEDED FOR CERTAIN DOD CONTRACTOR EMPLOYEES 31 (2008) (“We recommend . . . personal conflict of interest contract clause safeguards for defense contractor employees that are similar to those required for DOD’s federal employees.”); U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-693, STRONGER SAFEGUARDS NEEDED FOR CONTRACTOR ACCESS TO SENSITIVE INFORMATION 30 (2010) (recommending that the FAR Council provide guidance on the use of non-disclosure agreements as a condition to contractors’ accessing sensitive information and on “establishing a requirement for prompt notification to appropriate agency officials of a contractor’s unauthorized disclosure or misuse of sensitive information”); OFFICE OF GOV'T ETHICS, REPORT TO THE PRESIDENT & TO CONGRESSIONAL COMMITTEES ON THE CONFLICT OF INTEREST LAWS RELATING TO EXECUTIVE BRANCH EMPLOYMENT 38–39 (2006) (noting “expressions of concern” the Office has received regarding personal conflicts of interest and highlighting the possibility of agencies’ including contract clauses to deal with such issues); REPORT OF THE ACQUISITION ADVISORY PANEL, *supra* note 12, at 423–25 (concluding that additional safeguards were necessary in order to protect against contractor employee personal conflicts of interest and misuse of confidential information).

<sup>20</sup> REPORT OF THE ACQUISITION ADVISORY PANEL, *supra* note 12, at 418 (“Application of the specific federal employee ethics requirements to contractor personnel would require additional training, monitoring, and enforcement, and the cost of these efforts would be passed on to the government.”).



specific types of employees acting under those contracts) particularly likely to trigger ethical risks.

*“High Risk” Contracts*

*PCI-Risk Contracts:* Several statutes and regulations prohibit contractors from performing “inherently governmental functions,” which are defined as functions “so intimately related to the public interest” as to require performance by government employees.<sup>21</sup> The FAR also contains a list of activities that “approach” being classified as “inherently governmental functions.”<sup>22</sup> As a recent proposed policy letter from the Office of Federal Procurement Policy recognizes, contractors performing activities that are similar to “inherently governmental functions” should be subject to close scrutiny, given that the work that they perform is near the heart of the traditional role of the federal government.<sup>23</sup> Several of the functions listed as “approach[ing] . . . inherently governmental functions” involve activities wherein the contractor either advises in agency policymaking or participates in procurement functions on behalf of the government, which raise particular risks of employee personal conflicts of interest. Other activities identified as raising particular risks of employee personal conflicts of interest include “advisory and assistance services” and “management and operating” functions.<sup>24</sup>

The FAR contains provisions identifying service contracts involving activities that “approach” being “inherently governmental functions,”<sup>25</sup> feature “advisory and assistance services,”<sup>26</sup> or involve “management and operating” functions.<sup>27</sup> Some contracts such as those when a contractor employee performs discretionary tasks that could impact the public or that involve the expenditure of agency funds may pose a significant risk of personal conflicts of interest. There are several contracting tasks that, by their nature, elevate the risk of such conflicts, to include substantive (as compared to procedural) contract work (hereinafter referred to as “PCI-Risk” contracts) such as:

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<sup>21</sup> Federal Activities Inventory Reform Act of 1998, Pub. L. No. 105-270, § 5(2)(A), 112 Stat. 2382, 2384; 48 C.F.R. § 2.101; OMB, Circular A-76, Performance of Commercial Activities, Attachment A § B.1.a. Though each of these authorities uses slightly different wording in defining “inherently governmental function,” the differences are apparently of no legal significance. Office of Management & Budget, Work Reserved for Performance by Federal Government Employees, 75 Fed. Reg. 16,188, 16,190 (proposed Mar. 31, 2010).

<sup>22</sup> 48 C.F.R. § 7.503(d).

<sup>23</sup> Work Reserved for Performance by Federal Government Employees, 75 Fed. Reg. at 16193–94.

<sup>24</sup> REPORT OF THE ACQUISITION ADVISORY PANEL, *supra* note 12, at 411.

<sup>25</sup> 48 C.F.R. § 7.503(d).

<sup>26</sup> *Id.* § 2.101.

<sup>27</sup> *Id.* § 17.601.



- Evaluating another contractor's performance or contract proposal
- Supporting substantive acquisition planning<sup>28</sup> or research and development activities
- Assisting in the development of a statement of work or in contract management
- Preparing budgets, and organizing and planning agency activities
- Developing agency policy or regulations
- Working side-by-side federal employees on the same or similar taskings, or in circumstances where an outsider might mistake a contractor employee to be a federal employee
- Participating as a technical advisor to a source selection board or as a member of a source evaluation board (*i.e.*, boards designed to select or evaluate bids or proposals for procurement contracts)
- Providing alternative dispute resolution services on contractual matters; legal advice involving interpretation of statutes or regulations; significant substantive input relevant to agency decision-making; or professional advice for improving the effectiveness of federal management processes and procedures
- Serving as the primary authority for managing or administering a project or operating a facility

*Information Risk Contracts:* Existing regulations also do not comprehensively protect against contractor employees' disclosure or misuse of sensitive confidential information learned while performing government contracts.<sup>29</sup> As with personal conflicts of interest, specific activities pose a particularly grave risk of contractor misuse of confidential information, which include (hereinafter referred to as "Information-Risk" contracts):

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<sup>28</sup> The FAR Council currently has a proposed rule providing personal conflict of interest standards for contractor employees performing acquisition activities closely associated with inherently governmental functions. Preventing Personal Conflicts of Interest for Contractor Employees Performing Acquisition Functions, 74 Fed. Reg. at 58,588. This rule, to the extent it is ultimately implemented, would obviate the need for any additional FAR contract clause with respect to these contracts.

<sup>29</sup> U.S. GOV'T ACCOUNTABILITY OFFICE, STRONGER SAFEGUARDS NEEDED FOR CONTRACTOR ACCESS TO SENSITIVE INFORMATION, *supra* note 19, at 30 (recommending that the FAR Council provide guidance on the use of non-disclosure agreements as a condition to contractors' accessing sensitive information and on "establishing a requirement for prompt notification to appropriate agency officials of a contractor's unauthorized disclosure or misuse of sensitive information").



- Contracts in which certain employees will receive access to information relating to an agency's mission, management operations, or staff that is not generally released to the public.
- Contracts in which certain employees will have access to sensitive business-related information, such as trade secrets, classified financial information, or other non-public information that could be exploited for financial gain.<sup>30</sup>
- Contracts in which certain employees will have access to personally identifying or other sensitive personal information, such as social security numbers, bank account numbers, or medical records.<sup>31</sup>

### Recommendations

1. **The FAR Council should adopt a set of contract clauses to be used in contracts posing a high risk of personal conflicts of interest or misuse of information.** Current law does not adequately regulate against the risks of contractor employee personal conflicts of interest and misuse of confidential information. On occasion certain agencies impose additional ethics requirements by supplemental regulation or contract clauses. In addition, certain contractors, especially large companies, have imposed self-regulation by adopting and enforcing internal ethics codes. Nevertheless, coverage varies significantly from agency to agency and contract to contract. In order to bring consistency to this process and ensure that the government's interests are adequately protected, the FAR Council should adopt a set of contract clauses that agency contracting officers could utilize when negotiating contracts that are particularly likely to raise issues of personal conflicts of interest or misuse of information.

2. **The proposed FAR provision should recommend such clauses only in PCI-Risk and Information-Risk contracts.** A rule requiring that every government contract contain clauses dealing with personal conflicts of interest or misuse of information would potentially create excessive compliance costs for contractors and monitoring costs for agencies, and the FAR should only suggest such clauses for contracts for certain high-risk activities.<sup>32</sup> At the same time, contracting agencies should remain free to integrate contract clauses (or to promulgate

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<sup>30</sup> For instance, if an employee of a contractor performing auditing functions for the government were to learn that a large manufacturing firm intends to open a new plant in coming months, the employee could purchase property near the plant and reap a substantial financial windfall. The contemplated regime would require that the contractor train employees privy to such information on their obligations to keep the information confidential and to avoid transacting business on the basis of such information, penalize employees who violate such obligations, and report any employee violations to the contracting agency.

<sup>31</sup> *Id.* at 6.

<sup>32</sup> REPORT OF THE ACQUISITION ADVISORY PANEL, *supra* note 12, at 418.



supplemental regulations) dealing with personal conflicts of interest, misuse of information, or any other ethical risk they deem important whether or not the contract at issue qualifies as a PCI-Risk or Information-Risk contract. Thus, the proposed FAR clause would serve as a floor upon which agencies could build if they deemed it appropriate, but would not supplant existing programs that may provide greater protections.

3. **Individual agencies should have discretion on whether to use the FAR clauses and whether to modify them.** Contracting agencies intending to enter into contracts for one of the “high risk” activities should consider whether to integrate one of the standard FAR contract clauses into contracts negotiated with individual contractors. The contracting agency should have the discretion to modify the standardized contract clause(s) on a case-by-case basis to fit the circumstances and to decide to forego using any such contract clause if it deems that the particular contract at issue is unlikely to pose a significant risk of personal conflicts of interest or misuse of information by contractor personnel.<sup>33</sup>

4. **The FAR Council should draft a contract clause (or series of alternative contract clauses) dealing with contractor employee personal conflicts of interest.** Contracting agencies should consider inclusion of such a clause(s) in those contracts that qualify as one of the PCI-Risk contracts identified in the Preamble.

The standard FAR clause(s) should specify that the contractor must require any employees who have discretionary responsibility in performing the contract<sup>34</sup> to certify that neither they nor their spouses or minor children have any financial interests that would bias their judgment or advice provided to the government.<sup>35</sup> The contractor should be required to report to

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<sup>33</sup> For instance, if the Department of Defense entered into a \$5,000 contract with a company to identify a vendor to provide \$100,000 worth of orange juice for an Army mess hall, the contract would technically fall into the PCI-Risk category since it involves an acquisition function. Nevertheless, the contracting agency might choose not to integrate a contract clause protecting against personal conflicts of interest since neither the value of the contract itself nor the value of the product to be acquired is particularly large. It might conclude that the potential benefits of protecting against such a conflict of interest may not justify the probable monitoring costs.

<sup>34</sup> Every employee performing under the contract need not certify that he or she does not possess conflicting financial interests. For instance, in the case of a contract for providing budget preparation advice to the government (a function falling within one of the “high risk” categories), employees performing administrative or other non-discretionary tasks, such as those making copies of the report that the contractor will submit, need not perform such a certification.

<sup>35</sup> The FAR clause should implement a certification process rather than a disclosure process in order to minimize the burden on contractors. In order to fully execute their contractual obligations, contractors should train their key personnel on recognizing and disclosing personal conflicts of interest. In the case of an anticipated conflict, a contractor employee should disclose the issue to the contractor, who must then either screen the employee from performing under the contract or put in place some other mitigation plan designed to prevent misconduct by the



the contracting officer periodically on its efforts to protect against employee conflicts and to disclose any instances of employee misconduct (as well as disciplinary action taken against any offending employee). A contractor that fails to implement an adequate system for employee conflict certification, neglects to disclose or correct instances of employee misconduct, or does not take appropriate disciplinary measures against employees who commit misconduct may be subject to suspension or disbarment in appropriate cases.

5. **The FAR Council should draft a contract clause (or series of alternative contract clauses) dealing with contractor employee misuse of confidential information.** Contracting agencies should consider inclusion of such a clause(s) in those contracts that are identified as Information-Risk contracts in the Preamble.

The standard FAR clause(s) should require the contractor to ensure that its employees who have access to confidential information are made aware of their duties to maintain the secrecy of such information and to avoid using it for personal gain. To the extent an employee breaches either of these obligations, the contractor shall be responsible for minimizing the effects of the breach, disciplining the offending employee, and reporting the breach to the contracting officer. A contractor that fails to discharge these obligations and whose non-compliance results in significant harm to the government or that proves incapable or unwilling to fulfill its duties may be subject to suspension or disbarment.

6. **Agencies not covered by the FAR should use the FAR clause(s) as a resource when negotiating contracts for services falling in either of the “high risk” categories.** The FAR governs acquisitions by “executive agencies” and therefore does not apply to non-executive agencies.<sup>36</sup> Such agencies may nevertheless be exposed to risks of personal conflicts of interest and/or misuse of information by contractor employees. Thus, agencies not subject to the FAR should familiarize themselves with the contract clauses published therein and consider integrating such clauses into contracts falling into the PCI-Risk or Information-Risk categories.

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employee. The contractor shall be responsible for disciplining employees who fail to disclose conflicts or fail to honor the company’s conflict mitigation plan.

<sup>36</sup> 48 C.F.R. § 1.101.