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Implementation of Comprehensive Ethics Standards for Government Contractors and Contractor Employees

Draft Preamble

The Conference believes that certain important aspects of the ethics rules applicable to government employees should be extended to contractor employees in order to increase public confidence in the government's acquisition system. This should be done in a manner that is cost-effective, takes into account the disparate needs of the various agencies that utilize independent contractors, and is sensitive to the burdens that extension of the ethics system to contractor employees would impose on agencies and the companies and small businesses with which they contract.

Background

In recent years, the federal government has increasingly relied upon private contractors to perform services previously provided in-house by government employees. Indeed, the federal government now purchases more than \$260 billion of services every year, spending more on services than it does on physical goods.¹ Despite this expansion in the use of government contractors, there is a substantial disparity in the ethics rules regulating government employees and those regulating private contractors and their employees, who may be performing the same functions and whose observance of appropriate ethical rules is important for the integrity of governmental functions. Indeed, though an extensive array of ethical rules applies to government employees of all ranks (with more extensive rules applying to employees in more sensitive positions), the rules currently applicable to contractor employees vary significantly by agency, are generally imposed by contract terms rather than by statute or regulation, and in many cases are minimal or non-existent.

Public office is a public trust, and government ethics rules largely reflect the fiduciary nature of government service. An extensive set of restrictions applies to government employees, addressing their financial interests, use of government resources, outside activities, and employment options after leaving the government. Employees who violate these rules are subject to employment-related discipline and civil and/or criminal penalties. Agencies engage in

¹ In making its recommendation, the Conference notes that "personal service contracts" that create an employer-employee relationship between the federal government and contractor personnel are, in the absence of Congressional authorization, generally unlawful. 48 C.F.R. § 37.104. Despite this prohibition, as a matter of practice, the government makes extensive use of personal service contracts. Contractor employees and government employees often work side-by-side and perform effectively identical tasks. In light of the government's continuing use of personal service contracts despite this ban, the Conference believes that agencies should regulate the ethics of those contractor employees through the regime described below.



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extensive prophylactic efforts to prevent ethical lapses: training employees on their ethical duties, requiring hundreds of thousands of employees to disclose their financial interests, and reviewing those disclosures for conflicts.

In contrast, the current system defining the ethical obligations applicable to employees of government contractors is, at best, ad hoc, having generally evolved agency-by-agency and case-by-case. Only a few ethics statutes apply to both government employees and contractor employees. These include the prohibitions on bribery,² illegal gratuities,³ serving as a foreign agent,⁴ and disclosing sensitive procurement information.⁵ In addition, there are a few provisions (such as the anti-kickback statute⁶) that specifically regulate the ethics of contractor employees.

Congress has on occasion adopted statutes establishing ethical obligations for employees of contractors with certain agencies, notably the Department of Defense and the Federal Deposit Insurance Corporation. In particular, Congress recently adopted a statute that requires the Department of Defense and the other agencies that constitute the Federal Acquisition Regulation Council (“FAR Council”) to promulgate a rule to systematize the ethical obligations imposed on contractor employees performing acquisition functions on behalf of the government. The FAR Council has issued such a rule for public comment.⁷ A Federal Acquisition Regulation (“FAR”) also addresses “Organizational Conflicts of Interest,” in which a *contractor* has a conflict of interest that may compromise its objectivity in acting on behalf of the government, but there is no common regime regulating “Personal Conflicts of Interest,” in which a *contractor employee* has such a conflict.⁸ A handful of agencies have adopted ethics regulations for their contractors’ employees, but most of these regulations are narrow in scope. Several agencies that have the largest procurement processes with private contractors, including the Department of Defense and the Department of Energy with respect to its nuclear laboratories, have established through contract clauses a series of ethics restrictions and disclosure requirements that are applicable to contractor employees and administered by the contracting companies.

² 18 U.S.C. § 201(b).

³ *Id.* § 201(c).

⁴ *Id.* § 219.

⁵ 41 U.S.C. § 423.

⁶ *Id.* §§ 51–58 (prohibiting kickbacks to contractors, subcontractors and their employees).

⁷ Proposed Rule on Preventing Personal Conflicts of Interest for Contractor Employees Performing Acquisition Functions, 74 Fed. Reg. 58584 (Nov. 13, 2009) (implementing the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009, Pub. L. No. 110-417, § 841(a), 122 Stat. 4356, 4537–39).

⁸ 48 C.F.R. § 9.500 *et seq.* (regulating “organizational conflicts of interest” of government contractors).

**DRAFT 12/9/2010****Identification of Best Practices**

Of the few federal government instrumentalities that have adopted ethics regulations for their contractors' employees, the most comprehensive regime appears to be that imposed by the Federal Deposit Insurance Corporation ("FDIC") pursuant to a statute adopted by Congress in the 1990s.⁹ The FDIC prohibits contractors and their employees from (1) having financial or business interests related to the contract;¹⁰ (2) soliciting or accepting gifts from anyone whose interests could be substantially affected by the performance of contractual duties;¹¹ (3) using or disclosing confidential information obtained from the FDIC or a third party in connection with the contract;¹² (4) using or allowing the use of government property, except as specified in the contract;¹³ (5) providing preferential treatment;¹⁴ and (6) engaging in an outside activity that would impair independence.¹⁵ In addition, FDIC contractors are required to disclose waste, fraud and abuse.¹⁶ The FDIC implements this ethics regime by requiring contractors to train their employees on all applicable requirements, to certify that they are not subject to any conflict of interest, and to agree in writing to employ only persons lacking conflicts of interest.¹⁷

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 have also adopted regulations in some of these areas, but their regulations apply only to specific types of contracts rather than to all service contracts (as in the FDIC regulations). As noted, other agencies, such as the Department of Defense, have imposed ethics requirements on some of their contractor employees by including such provisions in particular contracts.

Analysis

In sum, the present approach to regulating government contractor ethics is inconsistent across agencies. In light of the fact that contractor employees perform many of the same

⁹ The FDIC's mission, admittedly, is unique and quite narrow. Moreover, it is by no means a major procuring agency. Indeed, it is not an executive agency; accordingly, it is not covered by the uniform, government-wide Federal Acquisition Regulation ("FAR"). 48 C.F.R. § 1.101; *see also* FDIC Acquisition Policy Manual § 1.208(b)(6) (Aug. 2008), *available at* <http://www.fdic.gov/buying/goods/acquisition/apm/3700-16.html>.

¹⁰ 12 C.F.R. § 366.10(a)(1).

¹¹ *Id.* § 366.12(d)(1).

¹² *Id.* § 366.13(a).

¹³ *Id.* § 366.12(d)(2).

¹⁴ *Id.* § 366.12(a).

¹⁵ *Id.* § 366.10.

¹⁶ *Id.* § 366.12(c).

¹⁷ *Id.* §§ 366.12(b), 366.14.



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services as government employees and that the use of government contractors has vastly expanded in recent years while the size of the federal workforce has remained relatively constant,¹⁸ the vast disparity between the extensive set of rules applicable to government employees and the relatively minimal set of rules applicable to contractor employees may appear improper.¹⁹ On the other hand, any attempt to expand the ethics regime applicable to contractors and their employees will necessarily increase compliance costs for contractors (which, in turn, will increase procurement costs for agencies) and monitoring costs for agencies. An appropriate system of ethical standards for contractor employees should therefore be carefully defined to identify and remedy the most pressing ethical issues without imposing an onerous regime with little marginal benefit in ensuring ethical conduct.

Accordingly, the Conference recommends that Executive Branch agencies adopt a uniform set of minimum ethical standards applicable to contractor employees reflecting the fiduciary nature of government service. Such a uniform system could be implemented either through issuance of an executive order²⁰ or by the FAR Council's adopting a rule that adopts a mandatory FAR clause imposing such standards. The Conference recommends the latter approach because the FAR Council has already acquired extensive expertise in the regulation of ethical issues, as reflected in the proposed rule that it has issued pursuant to Congressional directive. The FAR Council also could update and modify the proposed ethical regime as the need arises. Finally, the Conference recommends that individual agencies identify the ethics issues of greatest concern to them and adopt either targeted regulations or contract clauses to address those issues in a cost-effective manner. [NB: We are considering two options for the recommendation. This paragraph is based on the first option, which involves a mandatory ethics regime applicable to all agencies that individual agencies may supplement. To the extent we pursue the second option, which leaves the question of whether and how to adopt ethics rules to individual agencies, this paragraph will be modified accordingly.]

Draft Recommendation

1. General Standard Governing Implementation of Comprehensive Ethics Standards for Government Contractors and Contractor Employees: [NB: There are two possible options the sub-committee considered for implementing the system. "Option I"

¹⁸ PAUL R. VERKUIL, *OUTSOURCING SOVEREIGNTY: WHY PRIVATIZATION OF GOVERNMENT FUNCTIONS THREATENS DEMOCRACY AND WHAT WE CAN DO ABOUT IT* 6 (2007).

¹⁹ Indeed, to the extent that government contractor employees and federal employees perform precisely the same function, an agency can escape the strictures of government ethics standards merely by replacing its in-house workforce with a contractor workforce.

²⁰ See, e.g., Exec. Order No. 12731, 55 Fed. Reg. 42547 (1990) (imposing a common set of ethical rules on all government employees).



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provides that the FAR Council will adopt a minimum set of standards that apply to *all* contractors of executive agencies in provision 1, sets forth those standards at provisions 2–8, and then provides for individual agencies’ ability to supplement those at provision 9. “Option II” does *not* adopt a common standard applicable to all agencies but rather recommends that each individual agency consider a risk/task-based approach to address the ethics issues of concern to them. The recommendation would then either end there or list provisions 2–8 as possible options for agencies to consider.]

Option I: The Federal Acquisition Regulation (“FAR”) Council should consider drafting a mandatory FAR clause that would adopt the standards enumerated below as a minimum set of ethical rules applicable to service contractors and contractor employees who do business with all agencies covered by the FAR system.²¹ Individual agencies may consider adopting more stringent standards to the extent their service contractors and contractor employees face unique ethical issues not fully addressed by the common rules.

The FAR clause should require that each contractor implement internal mechanisms to train employees on their ethical obligations, to protect against violations of the rules, and to mitigate any violations that occur (including employee discipline). The FAR Clause also should provide that the contracting agency may terminate the contract for material breach of the ethical standards by contractor employees and hold the contractor liable for any damages caused by the breach. In addition, the contracting agency should be authorized to suspend or bar contractors from further contracting based on past violations.

Option II: Each executive agency should identify the ethical risks that confront its contractors and contractor employees. The agency should both consider past issues it has confronted and what ethical standards it envisions as necessary to ensure that its contractors and contractor employees act in the best interests of the government. In doing so, each agency should consider whether it foresees ethical risks in the following areas: (a) personal conflicts of interest; (b) gifts; (c) use of government property; (d) use of confidential information; (e) contractor employee interactions with the public; and (f) any other area deemed significant.

²¹ Of course, not all contracts are easily divisible into those dealing with “goods” and those dealing with “services.” For instance, a construction contract may involve both the provision of goods (e.g. concrete for the construction of a bridge) and attendant services (e.g. the labor involved in building the bridge). Accordingly, the Ethics Standards described in this Recommendation should apply only to contracts where the services component predominates. *See, e.g., Magrine v. Krasnica*, 227 A.2d 539, 543 (Hudson County Ct. 1967) (holding that a dentist is not liable under strict product liability for “dispensing” a defective syringe he used in a procedure insofar as the “essence” of the transaction related to services and not incidental distributed goods).



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After having identified areas of risk, each agency should then determine whether adopting ethical rules regulating those risks would be cost-effective and, if so, what ethical standards the rules should impose on contractors and contractor employees. In addition, the agency should consider whether to adopt rules by a rulemaking process or instead to impose rules on a contract-by-contract basis through appropriate clauses integrated into individual contracts. Finally, each agency should determine the appropriate consequences for violation of its rules.

The FDIC and the Troubled Asset Relief Program have adopted the most extensive contractor employee regulations to date, and the following points represent “best practices” based on those agencies’ experiences that other agencies might want to consider in designing their ethical standards (to the extent it is cost-effective for them to adopt such regulations in light of the risks identified).

2. **Directly Supervised Employees:** Contractor employees often work side-by-side with government employees within the same office. In order to address this reality, to eliminate disparate treatment, and to provide comparable standards for both government employees and employees of federal contractors who effectively act as government employees, the FAR Council should adopt a mandatory FAR clause which mandates that any service contractor employee who performs functions or activities of the executive branch under the direct supervision of a government employee is deemed to be covered by the ethical standards for government contractors and contractor employees.

Further, Congress should also consider enacting a statute repealing the “personal services prohibition” but mandating that such service contractor employees are deemed to be government employees for purposes of government ethics statutes.

3. **Personal Conflicts of Interest:** For purposes of this and subsequent provisions, “participating employees” shall be defined to include all officers or directors of the contractor and all employees who possess discretion in how the agency will accomplish its obligations under the contract. For instance, a person providing carpentry services under a construction contract would not qualify insofar as he or she performs his or her contractual obligations entirely according to set specifications, but a supervisor responsible for hiring sub-contractors to complete the contract would qualify. For service contracts exceeding \$ 5,000,000, the contractor should identify any personal, business, or financial interests its participating employees²² or their

²² A similar regime already applies to conflicts between the interests of the *contractor* and those of the federal government. See 48 C.F.R. § 9.500 *et seq.* This Recommendation provides only for additional regulations covering conflicts between the interests of *contractor employees* and those of the government.



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spouses or close relatives (minor child or any other family member with whom the individual has a close personal relationship) possess that may compromise their objectivity under the contract.²³ Such interests include, *inter alia*, ownership interests in a competing business entity, employment with another organization whose interests might be affected by the performance of the contract, and participating in litigation against the contracting agency. “Ownership interest” in a competing entity does not include ownership of common stock unless if the person owns sufficient shares to wield a controlling interest in the company.

After surveying for conflicts, the contractor should: (a) certify prior to commencing work on any contract that no participating employee has a conflict; (b) disclose any conflicts of participating employees and request a waiver of each such conflict; or (c) disclose any conflicts of participating employees and propose a mitigation plan (e.g. screening all conflicted participating employees from performing work under the contract). To the extent a conflict exists, the contracting agency may then waive the conflict, accept the proposed mitigation plan or offer an alternative mitigation plan to the contractor, or abandon the contract.

4. **Gifts:** For purposes of this provision, the term “gift” shall have the same meaning as is set forth in 5 C.F.R. § 2635.203. A service contractor or its participating employees may not accept or solicit any gift from any person outside of the company who is seeking official action or who has some interest substantially affected by the performance or non-performance of the contract.

5. **Use of Government Property:** To the extent a service contractor or its employees are allowed to use agency property in the performance of the contractual obligations, they must not improperly use or allow another to use the property for the benefit of any person or organization other than the contracting agency.

6. **Use of Government Information:** For purposes of this provision, “confidential information” is defined as non-public information that is protected from disclosure by statute or executive order. A service contractor or contractor employee may not disclose confidential

²³ The means of gathering this information shall be left to the discretion of the contractor in order to allow it to gather relevant information in the manner it deems most efficient. One system a contractor might adopt would be an annual disclosure requirement whereby employees state all major business interests and stock holdings. The contractor could then review this information in determining whether any of these holdings would interfere with any employee’s ability to act objectively under the contract, such that the conflict should be disclosed. The internal enforcement system should also be left to the contractor’s discretion, allowing it to determine the best means of disciplining employees who fail to disclose conflicts.



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information obtained from the contracting agency or use such information to further its own interest or that of a third party except as required under the contract or by court order.

7. **Preferential Treatment:** A service contractor or person performing work under a contract shall not provide preferential treatment to anyone in his or her dealings on behalf of the government.

8. **Training:** Service contractors shall be responsible for ensuring that their employees are aware of their ethical obligations and should implement appropriate training to ensure that they may successfully discharge their duties.

9. **Agency-by-Agency Supplementation:** The aforementioned guidelines address many of the ethics issues that inhere in the use of government contractors and therefore should apply to all agencies subject to the FAR. In many instances, agencies may confront additional problems requiring more stringent versions of these rules or additional rules covering specific issues. Accordingly, the FAR provision establishing these standards should create a minimum ethics regime upon which agencies may build as appropriate.²⁴ In doing so, agencies should consider adopting a “risk/task” based system. Under such a system, each agency would identify the primary ethical risks other than those addressed by the common ethics regime its contractors and their employees confront. The agency would then assess whether implementing additional regulations justifies the costs that doing so would create for contractors and the agency itself. If deemed cost-effective, the agency should then implement specific contract provisions addressing the potential ethical risks in each contract.

²⁴ See, e.g., Exec. Order No. 12731 (1990) (setting forth a comprehensive regime of ethical rules applicable to “all executive branch employees” but also encouraging each individual agency to “[s]upplement” that regime “with regulations of special applicability to the particular functions and activities of that agency”).