Be Careful What You Wish For: Government Contracting and the Unwary Contractor – Current Ethics Issues & Obligations, Part III

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This article is the final installment of a three-part series about current issues involving ethics and government contracting. Throughout this series, we have emphasized the importance for companies contracting with the federal government – either directly or indirectly – to understand that federal laws and regulations may, and often do, apply to their contract or subcontract, imposing rigorous ethical standards and compliance burdens.

Part I of this series provided a general overview of government contracts ethics issues, including the now almost universally required Code of Government Contracts Ethics & Conduct; Whistleblower Protections; False Claims Act, Kickbacks and Gratuities Laws.

In Part II, we discussed in more detail the Federal Acquisition Regulation (FAR)-imposed Code of Business Ethics and Conduct, the requirement of pricing independence and the government’s concerns and requirements regarding procurement integrity. We also touched on the government’s treatment of contractors’ confidential and proprietary business information.

In this third and final part of the series, we will discuss the Covenant Against Contingent Fees, regulation of organizational conflicts of interest (OCIs) and the debarment and suspension procedures the government uses to remove perceived violators from the federal contracting pool.

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Covenant Against Contingent Fees

In the private, commercial context, it is typically not illegal for contractors with an existing relationship with an owner to “sell” access to other contractors or subcontractors in exchange for a contingent fee. In the government contracting realm, however, these types of arrangements generally are forbidden. This relates to a number of already discussed topics, including the anti-collusion/bid rigging and kickbacks and gratuities elements of ethics. In addition, under what is known as the “Covenant Against Contingent Fees,” a contractor is not permitted to pay a contingent fee (e.g., a commission) to any contractor, employee or independent agent in an attempt to obtain a government contract. FAR 3.401 defines a “contingent fee” as “any commission, percentage, brokerage, or other fee
that is contingent upon the success that a person or concern has in securing a Government contract.” Contracts obtained through contingent fees are generally viewed as being the result of, or giving the mere appearance of, improper influence, defined as “any influence that induces or tends to induce a Government employee or officer to give consideration or to act regarding a Government contract on any basis other than the merits of the matter.”

The driving policy reason behind the covenant goes to procurement integrity: the government wants to ensure that contractors are selected based on their technical capabilities, their quality, their responsiveness and the value they provide, and not based on “who knows who” and the influence they may be able to exert. FAR 3.402 states that “[c]ontractors’ arrangements to pay contingent fees for soliciting or obtaining Government contracts have long been considered contrary to public policy because such arrangements may lead to attempted or actual exercise of improper influence.” The government’s remedies for a “…[c]ontractor’s violating the covenant against contingent fees includes cancellation of the contract or, in its discretion, to deduct from the contract price the full amount of the contingent fee. The [c]ontractor’s misrepresentation in its warranty against contingent fees also exposes it to false claims and false/fraudulent statement liability.”

Accordingly, FAR 3.404 requires that the contracting officer insert the following FAR 52.203-5 clause and warranty in every solicitation and contract exceeding the simplified acquisition threshold of $150,000 (excerpted here in pertinent part):

- **a)** The Contractor warrants that no person or agency has been employed or retained to solicit or obtain this contract upon an agreement or understanding for a contingent fee, except a bona fide employee or agency. For breach or violation of this warranty, the Government shall have the right to annul this contract without liability or, in its discretion, to deduct from the contract price or consideration, or otherwise recover, the full amount of the contingent fee.

- **b)** “Bona fide agency,” as used in this clause, means an established commercial or selling agency, maintained by a contractor for the purpose of securing business, that neither exerts nor proposes to exert improper influence to solicit or obtain Government contracts nor holds itself out as being able to obtain any Government contract or contracts through improper influence.

“Bona fide employee,” as used in this clause, means a person, employed by a contractor and subject to the contractor’s supervision and control as to time, place, and manner of performance, who neither exerts nor proposes to exert improper influence to solicit or obtain Government contracts nor holds out as being able to
obtain any Government contract or contracts through improper influence.

Note the exceptions for a “bona fide” employee or agency. This represents a potentially large, but poorly defined, loophole. As the clause states, a bona fide employee or agency is an agent the contractor relies on to contact the government, but who does not assert any improper influence. This could include an internal “sales” or business capture person or an outside agency. Case law applying this bona fide exception has generally looked at whether the entity receiving the fee improperly influenced the government on the contractor’s behalf. Factors that courts and administrative boards look at to determine whether the employee or agent is bona fide are fact-intensive but may include:

1. The nature of the agency relationship, i.e., whether the arrangement has continuity;
2. Whether the agency itself is an established firm;
3. Whether the agents involved have adequate knowledge of the principal’s product line;
4. The character of the service rendered (an agency hired to obtain one or more specific government contracts is less likely to be held bona fide than one employed to obtain government and commercial business generally);
5. The level of effort and amount of time dedicated to the agent’s work; and
6. The amount and reasonableness of the fee and whether the fee is wholly or partially based on the sales work.¹

Needless to say, these factors are subjective and thus the bona fide exception always presents some risk that contractors will be found to have violated the covenant against contingent fees. Contractors considering engaging in these types of contingent fee arrangements should carefully consider the arrangement’s terms with the help of counsel.

Organizational Conflicts of Interest (OCIs)

When an incumbent government contractor or one or more of its employees obtains “insider” information resulting from its performance of a government contract or by assisting the government in preparing or reviewing contract documents and proposals, there is a general presumption that that contractor can obtain an unfair competitive advantage in future, usually related, competitions. This gives rise to what is known as an organizational conflict of interest or “OCI.” The government regulates OCIs through FAR Subpart 9.5. The primary consequence of a conflict of interest is that the conflicted contractor cannot be awarded the contract in which it has a conflict unless it can successfully demonstrate that it can mitigate, neutralize or avoid the conflict. While an OCI typically does not result in criminal or civil liability, an agency’s finding that a

contractor has an unmitigatable or undisclosed OCI can have dire consequences for the contractor’s line of business with the relevant agency. It also exposes the contractor to bid protests from unsuccessful offerors who believe that they would have won a contract if not for improper OCIs by the awardee contractor.

The FAR does not provide a rigid definition for when an OCI exists but instead recognizes that identification of an OCI depends heavily on the facts and circumstances of each case. FAR 9.502 states that “an organizational conflict of interest may result when factors create an actual or potential conflict of interest on an instant contract, or when the nature of the work to be performed on the instant contract creates an actual or potential conflict of interest on a future acquisition.” The FAR identifies two primary concerns at the heart of OCIs: (a) the existence of conflicting roles that might bias a contractor’s judgment or (b) where a contractor competing for award of any federal contract has a competitive advantage because it possesses proprietary information or source selection information that is not available to all competitors and that would assist the contractor in obtaining the contract.

Courts and boards generally recognize three types of OCIs:

(1) “Biased ground rules,” wherein a contractor performing a government contract is involved in preparing the rules or requirements for winning a future contract, resulting in its being able to “skew” those rules and requirements in its favor (e.g., performs the design for an item or project to be later procured separately);

(2) “Unequal information,” where a government contractor gains access to information not known to other competitors that it can use to its advantage to win a future contract; or

(3) “Impaired objectivity,” where a government contractor performing auditing, oversight or similar evaluative services would have the opportunity to evaluate itself, resulting in the natural inference of bias.

FAR 9.505-1 through 9.505-4 provides a series of relatively straightforward rules where an OCI exists that must result in some restriction on the contractor’s procurement eligibility – these are more or less consistent with the three types of OCIs.

- A contractor that provides technical direction, prepares specifications, or provides evaluation services, systems engineering and technical direction for an agency “shall not” be awarded a contract to supply the system or its major components or be a subcontractor or consultant to the supplier (FAR 9.505-1).

- A contractor that prepares the specifications or work statements for non-developmental items “shall not” be permitted to furnish those items for a reasonable period of time – subject to narrow exceptions (FAR 9.505-2).
• A contractor that provides evaluation services for an agency cannot evaluate its own products and services (FAR 9.505-3).
• A contractor that obtains access to proprietary information to perform a government contract cannot compete for other contracts if the information it obtains would result in the contractor gaining an unfair competitive advantage (FAR 9.505-4).

In addition, FAR 9.508 provides several “examples” that illustrate situations where an OCI “may arise.” For instance, FAR 9.508(a) explains: “Company A agrees to provide systems engineering and technical direction to the Navy on the powerplant for a group of submarines (i.e., turbines, drive shafts, propellers, etc.). Company A should not be allowed to supply any powerplant components. Company A can, however, supply components of the submarine unrelated to the powerplant (e.g., fire control, navigation, etc.). In this example, the system is the powerplant, not the submarine, and the ban on supplying components is limited to those for the system only.”

Importantly, these examples are not all-inclusive, but all stem from the fundamental concerns about protecting fair competition and maintaining procurement integrity. In most cases, contractors or contracting officers who believe an OCI may exist are tasked with having to analyze the specific facts of a situation to determine whether it is a true conflict and what measures it should undertake, if any, to mitigate that conflict. FAR 9.504(e) states that the contracting officer “shall award the contract to the apparent successful offeror unless a conflict of interest is determined to exist that cannot be avoided or mitigated. Before determining to withhold award based on conflict of interest considerations, the contracting officer shall notify the contractor, provide the reasons therefor, and allow the contractor a reasonable opportunity to respond.”

See also FAR 9.506, “Procedures.” Perhaps in an attempt to proactively identify OCIs, the FAR also requires that contracting officers who anticipate a potential OCI include a provision in the solicitation that identifies the OCI concern and invites offerors to submit an OCI mitigation plan that explains what the offeror will do to neutralize, avoid or mitigate the conflict (FAR 9.507-1). For a contractor whose contract activities may implicate one or more common conflicts of interests, a robust and carefully tailored OCI mitigation plan can be invaluable in allowing that contractor to pursue future government work. Likewise, an insufficient OCI mitigation plan can cost a contractor valuable contracting opportunities.

Suspension and Debarment

With the exception of OCIs, this series has predominantly discussed ethical rules and standards that, if violated, expose contractors to extensive, and often severe, civil and/or criminal penalties. Another important power the government has is the ability to suspend or debar government contractors. These remedies, which,
while tied to the False Claims Act, are administrative and also stand alone, can make the affected contractor ineligible to bid on or win future government contracts for the duration of its suspension, or, in the case of debarment, for protracted periods of time (FAR 9.405). This includes ineligibility as a subcontractor for another otherwise responsible contractor (FAR 9.405-2). Agencies may in their discretion permit the suspended or debarred contractor to continue on contracts they currently are performing, subject to certain rules and restrictions (FAR 9.405-1). To avoid debarment, the burden is on the contractor to demonstrate to the debarring official of its present responsibility and that debarment is not necessary (FAR 9.406-1(c)). The decision to debar a contractor must be established by a “preponderance of the evidence” (FAR 9.406-3(d)(3)).

Suspension and debarment is rarely mandated by law and most debarment decisions are permissive and left to the discretion of the given agency’s Suspension and Debarment official. FAR 9.406(a) provides that “[i]t is the debarring official’s responsibility to determine whether debarment is in the Government’s interest” and “the debarring official may, in the public interest, debar a contractor for any of the causes in 9.406-2, using the procedures in 9.406-3.” The government’s stated policy is to avoid suspending or debarring federal contractors; per FAR 9.402, “The serious nature of debarment and suspension requires that these sanctions be imposed only in the public interest for the Government’s protection and not for purposes of punishment.”

FAR 9.406-2 contains a long list of potential causes for debarment. Most relevant to this ethics series are:

(a) … conviction of or civil judgment for—
   (1) Commission of fraud or a criminal offense in connection with— (i) Obtaining; (ii) Attempting to obtain; or (iii) Performing a public contract or subcontract.
   (3) Commission of embezzlement, theft, forgery, bribery, falsification or destruction of records, making false statements, tax evasion…
   (5) Commission of any other offense indicating a lack of business integrity or business honesty that seriously and directly affects the present responsibility of a Government contractor or subcontractor.

(b) (1) (vi) Knowing failure by a principal, until 3 years after final payment on any Government contract … to timely disclose to the Government, in connection with the award, performance, or closeout of the contract or a subcontract thereunder, credible evidence of— (A) Violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 of the United States Code; (B) Violation of the civil False Claims Act (31 U.S.C. 3729-3733); or (C) Significant overpayment(s) on the contract…
Many of the ethics issues that we have covered in this series directly implicate the government’s suspension and debarment powers. Note, too, that FAR 9.406(b)(vi), quoted above, states that a contractor can be suspended or debarred if it fails to comply with the mandatory disclosure requirement at FAR 2.1003 that we discussed in Part I of this series. Thus, even if a contractor or subcontractor is not directly liable for violating a law or regulation, it can be penalized for failing to disclose credible evidence of another party’s violation in connection with the contract it is performing.

Conclusion

The opportunities that government contracts bring to the contractor community are often high-profile, engaging and valuable. Contractors and subcontractors who decide to enter this world can expect to reap many benefits from their relationship with the government but also must be wary of the heightened standards and potential pitfalls that come with their role as a government contractor. We hope this series has been helpful in understanding the key risks involved in government contracting. We look forward to speaking with contractors and subcontractors as needed to help them attain their business goals while mitigating their risk.

This article should not be construed as legal advice. For more information, contact Lawrence M. Prosen, Daniel P. Broderick or Christian F. Henel.