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The Draft OCI Rule - New Directions and the History of Fear

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FEATURE COMMENT: The Draft OCI Rule—New Directions And The History Of Fear

After years of rancor and debate, the Office of Federal Procurement Policy and the FAR Councils have finally issued a proposed revision to the regulations governing organizational conflict of interests (OCIs) in federal procurement. 76 Fed. Reg. 23236 (April 26, 2011). The proposed rule marks an extraordinary change of direction—in some ways, it reorders policy priorities built up over years of case law—and may reflect, in many ways, the drafters' nagging ambivalence about the new direction. The drafters should take heart, though: the proposed rule generally marks a healthy new course, a strong step forward in rules that will likely continue to evolve for many decades to come.

A Brief History of OCI Regulation in the U.S. Federal System—The law regarding OCIs in the U.S. federal procurement system is, in many ways, among the most sophisticated in the world. While prohibitions against what we call OCIs emerge in procurement regimes around the world, including the European Union, see Directive 2004/18/EC, prefatory para. (8) (2004), and the World Trade Organization's Agreement on Government Procurement, see GPA Art. VI.4 (1994), the OCI rules that have evolved in our federal system seem, in many ways, the most elaborated. The new directions that the proposed rule marks may, therefore, serve as guideposts for future reforms abroad.

Although the foreign laws governing OCIs typically focus on contractors that may help write distorted specifications to gain an improper competitive edge in a future procurement—what we will call "biased ground rules" OCIs—the original U.S. OCI rules in the early 1960s grew out of a different, more amorphous fear. The concern then was that large weapon system integrators, which dominated the military-industrial complex at that time, would control competitions by controlling critical design information—that they would gain "unequal access to information," due to inside information. See Taylor, "Organizational Conflicts of Interest/Edition II," Briefing Papers No. 84-08, at 1 & n.7 (August 1984) (citing authorities).

As the OCI rules were codified in the new Federal Acquisition Regulation in 1984, see 48 Fed. Reg. 42102, 42152 (1983), the new FAR provisions, based on the previous guidance used by the Department of Defense, see 45 Fed. Reg. 51253 (1980); Taylor, "Organizational Conflicts of Interest in Defense Contracting," 14 Pub. Cont. L.J. 158 (1983), took a relatively conservative approach and, among other things, did not impose postaward OCI disclosure obligations on contractors. See Taylor and Dickson, "Organizational Conflicts of Interest Under the Federal Acquisition Regulation," 15 Pub. Cont. L.J. 107, 111–12 (1984) (citing authorities). The FAR provisions were made part of FAR pt. 9, which governs determinations of contractor qualifications ("responsibility" in the U.S. system) before contract award. See FAR 9.100; see, e.g., Madden, Pavlick and Worrall, "Organizational Conflicts of Interest/Edition III," Briefing Papers No. 94-08, at 3 (July 1994). While the 1984 FAR provisions extended the scope of OCI review, the core concern remained *pre*-award, to ensure fair competition. See, e.g., Taylor, supra, Briefing Papers No. 84-08, at 2.

In the following years, much of the OCI regulatory regime was written by the General Accounting Office (later the Government Accountability Office), in its decisions on bid protests. See generally Szeliga, "Conflict and Intrigue in Government Contracts: A Guide to Identifying and Mitigating Organizational Conflicts of Interest," 35 Pub. Cont. L.J. 639 (2006) (discussing authorities). The seminal GAO decision was *Aetna Gov't Health Plans, Inc.*, Comp.

Gen. Dec. B-254397 et al., 95-2 CPD ¶ 129 (1995); see Cantu, "Organizational Conflicts of Interest/ Edition IV," Briefing Papers No. 06-12, at 1 (November 2006), a 1995 decision drafted by Daniel Gordon, who now—in an interesting historical twist—heads OFPP. GAO's decision in *Aetna* tried to make sense of the OCI regulations by identifying three distinct types of OCIs:

- "Unequal access to information" OCIs, which arise when a firm has access to non-public information that can lead to a competitive advantage in a later procurement.
- "Biased ground rules" OCIs, which arise when a firm, as part of "its performance of a government contract, has in some sense set the ground rules for another government contract by, for example, writing the statement of work or specification."
- "Impaired objectivity" OCIs, which arise when a contract requires the exercise of judgment by the contracting firm, and the economic interests of the firm may distort the free and unbiased exercise of that judgment.

Aetna, at 8–9; Cantu, supra, at 1–2; FAR subpt. 9.5.

Of the three types of OCIs identified in *Aetna*, the impaired objectivity OCIs appeared to trigger the most concern at GAO. This seemed, in part, due to the fact that "impaired objectivity OCIs are the most difficult to identify because they are not limited to the contract itself; rather, they depend on whether the contractor's judgment could be affected by activities not related to the contract." Bartley, "Too Big to Mitigate? The Rise of Organizational Conflicts of Interest in Asset Management," 40 Pub. Cont. L.J. 531, 539 (2011); see Gordon, "Organizational Conflicts of Interest: A Growing Integrity Challenge," 35 Pub. Cont. L.J. 25 (2005). That difficulty of monitoring potential conflicts, plus a deeper fear that contractors were penetrating too deeply into Government decision-making, helped to launch a series of decisions at GAO sustaining protests based on "impaired objectivity."

What stood out in these impaired objectivity cases was GAO's general unwillingness to accept the affected contractors' arguments that, by erecting firewalls (procedures and physical security measures intended to block the flow of information), the contractors could eliminate the bias that might infect their objective advice to the Government. See, e.g., Gordon, supra, at 38–39 ("Where an 'impaired objectivity' OCI is at issue, it is difficult to see how a firewall within the conflicted organization would mitigate the OCI, in light of the assumption in these OCIs that all employees of the organization will work to further the organization's interest."); Bartley, supra, at 541 n.64 ("GAO has held that a firewall 'is virtually irrelevant to an [OCI] involving potentially impaired objectivity.' " (citing authorities)).

That fear that contractors' judgment would be corrupted, and the broader bulk of GAO precedent on OCIs, played an important part in shaping DOD's draft revision of the OCI provisions in the Defense FAR Supplement, which DOD published in April 2010. 75 Fed. Reg. 20954 (April 22, 2010). The draft DFARS rule carried forward that fear of corrupted contractor judgments, and made it clear that firewalls, standing alone, could not resolve impaired objectivity OCIs. Id. (a "firewall by itself, without any additional mitigation actions, is appropriate to resolve only 'unfair access to non-public information' organizational conflicts of interest").

Shortly after the draft DFARS rule was published, however, a new consensus began to emerge. The draft DFARS rule was heavily criticized by senior members of the procurement bar, in part because the DFARS rule in many ways simply codified the GAO case law on OCIs. There was, in other words, support for a new way forward.

Proposed OCI Rule—The final DFARS rule set the stage for the latest draft rule, which would apply Government-wide. Recognizing that a new consensus was emerging, the drafters of the DFARS rule cut back its scope, to make it applicable only to major weapon system procurements by DOD. 75 Fed. Reg. 81908 (Dec. 29, 2010). Although there was statutory authority for this narrower approach—the enabling statute had, in fact, called only for rules governing weapon system procurement—DOD's decision to retrench suggested that the Government-wide rule, when it emerged, would take a very different approach. The proposed OCI rule published last week proved that forecast correct.

The key elements of the proposed rule are set forth in accompanying Table 1. Some of the more interesting aspects of the proposed rule:

- **An Apparent Ambivalence:** The prefatory comments suggest deep ambivalence about the rule's new direction. The drafters ignore the final DFARS rule, and instead suggest that the *original* proposed DFARS rule—which tracked GAO's case law—offers an approach as valid

as the draft Government-wide OCI rule. As a practical matter, however, now that OFPP and the FAR Councils have staked out a position that at least *seems* an evolutionary step beyond the DFARS draft rule, it will be difficult for the drafters of the Government-wide OCI rule to reverse direction, to retreat to the more "traditional" position in the proposed DFARS rule.

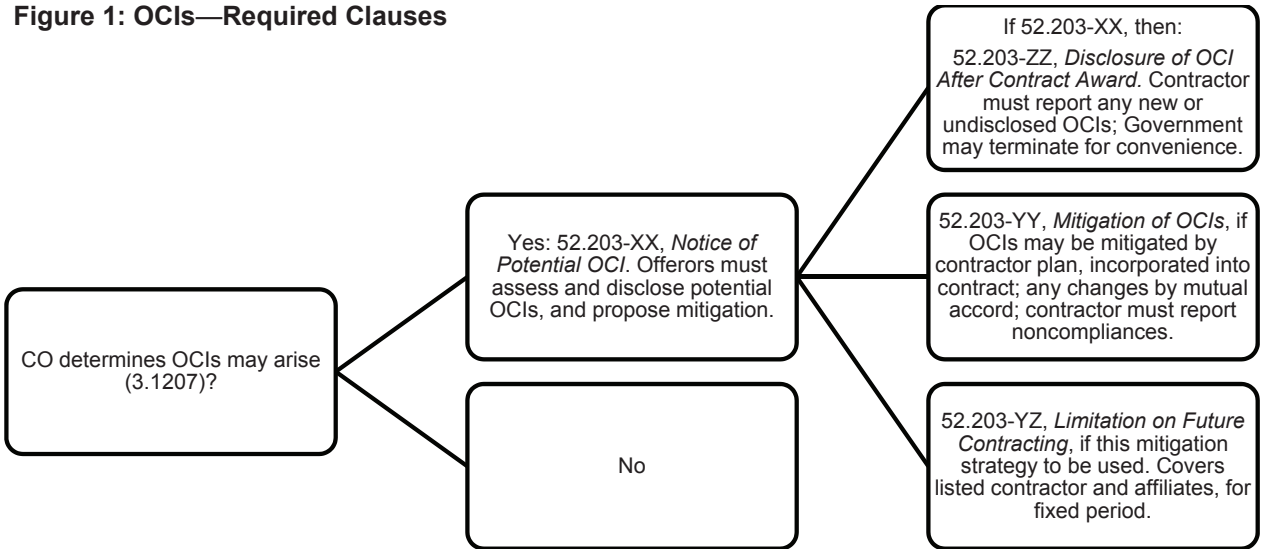
- **Rule Removed to Part 3:** Following the lead of the DFARS drafters, the FAR Councils and OFPP would move the Government-wide OCI rule from FAR pt. 9 (contractor qualification) to pt. 3 (improper business practices). This remains a puzzling and internally conflicted decision. On one hand, the move reflects a rough assumption that OCIs, like personal conflicts of interest, should be dealt with under FAR pt. 3, where other anticorruption measures appear. On the other hand, the thrust of the proposed rule is that OCIs are *not* necessarily corrupt—in fact, as is discussed below, under certain circumstances a contracting officer may decide that the risks an OCI poses are marginal compared to the benefits of using a particular contractor.
- **OCIs Likely Dealt with as Matters of Contractor Qualification:** Another reason to move the OCI provisions back to FAR pt. 9 is that, as a practical matter, OCIs are likely to be dealt with as issues of contractor qualification anyway. As Table 1 reflects, the proposed rule would

TABLE 1: SUMMARY OF KEY ELEMENTS OF DRAFT FAR ORGANIZATIONAL CONFLICT OF INTEREST (OCI) RULE

	OCI: Contractor May Distort Competition ("Biased Ground Rules")	OCI: Potentially Biased Contractor Advice ("Impaired Objectivity")	Unequal Access to Information (no longer OCI)
Threat:	Impair integrity of competitive process	Risk that Government's business interests impaired	Contractor may misuse non-public information, or use for unfair competitive advantage
Required CO early assessment (3.1206-1), case by case (3.1206-2), in evaluation process (3.1206-3), and award (3.1206-4):	CO must require agency to produce list of support contractors that drafted specifications, etc. (3.1206-2); CO should not rely solely on offerors' information (3.1206-3)	• If OCI risk is an *evaluation factor*, communications that could result in changes to mitigation plan constitute *discussions* • OCI risk may instead be part of *contractor qualification assessment*; may withhold award because of OCI only after allowing offeror to respond (3.1206-4)	CO must assess bidders' potential access to information; must insert clauses and provisions (4.401-4) (see Fig. 2)
CO discretion:	CO *must* take action to substantially reduce or eliminate risk (3.1203(b)(2))	CO has broad discretion, and may accept risk (3.1203(b)(3))	CO must act if concludes (see 4.402-3 and -4 (steps to analysis)) that unequal access to non-public information would give unfair advantage

How to address or resolve problem:	To address OCIs (3.1204-1) (see required clauses, Fig. 1, below):
	• **Avoidance**
	  • Redraft statement of work to reduce subjective judgment
	  • Require firewalls and other protective controls
	  • Exclude offeror (only as last resort), and, *if potential unfair distortion of competition,* only after assessing whether firewalls and compliance efforts (i.e., mitigation) are enough
	• **Neutralization** through fixed limits on future contracting
	• **Mitigation**, potentially per contractor mitigation plans (3.1206-3(b)), under Government oversight (3.1204-3):
	  • Delegation of work to conflict-free subcontractor
	  • *To remedy potentially biased advice* (3.1204-3(c)(2)): requiring contractor to use controls and firewalls (though firewall to block information flow alone generally not sufficient); may include contractor OCI compliance officer
	  • Obtaining advice from more than one source
	• **Determining risk is acceptable** to Government (applicable *only* to "impaired objectivity" OCIs) (3.1204-4)
	Waivers disfavored (3.1205; 3.1206-4 (best interests determination))
			To resolve unequal access to information (4.402-4):
			• **Dissemination** by sharing non-public information with all,
			• **Mitigation** through firewalls (e.g., organizational or physical separations, access restrictions; info systems restrictions; independent compensation systems; nondisclosure agreements), subject to CO's approval, perhaps simply by contractor confirming compliance with 52.204-XX, *Access to Non-public Information,* **and/or**
			• **Disqualification**, if no other means (4.402-2)

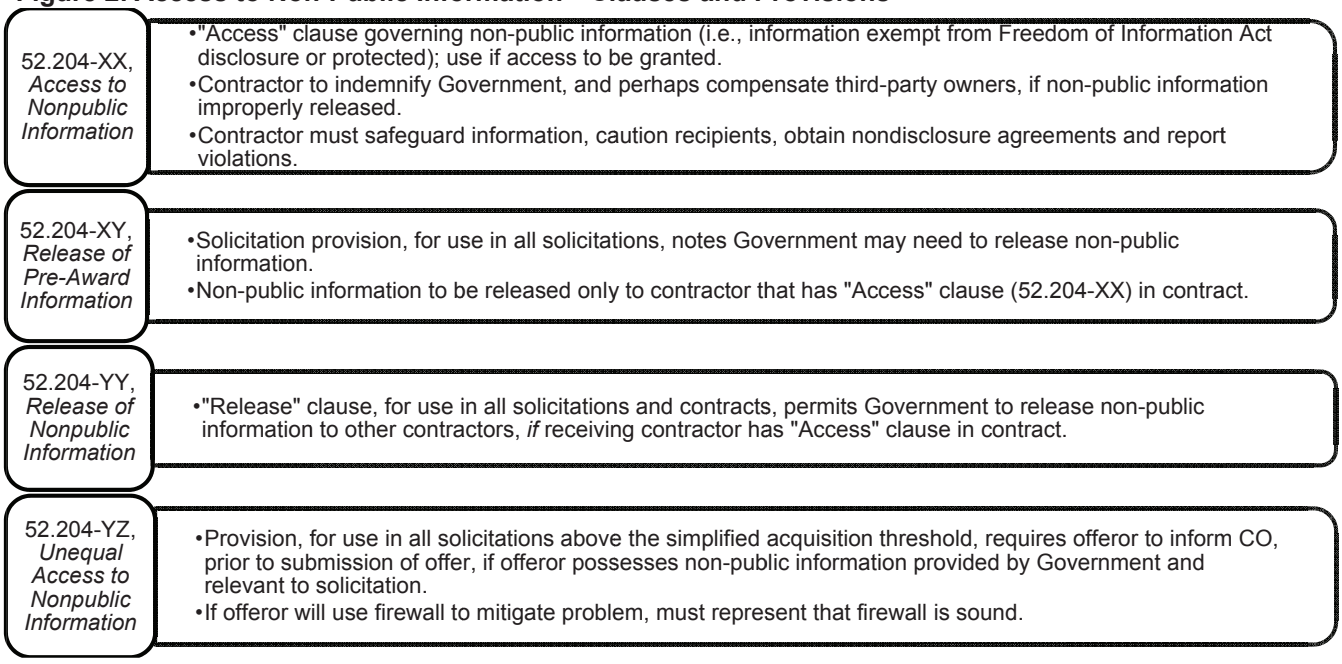
Figure 1: OCIs—Required Clauses



allow COs to assess OCIs during the evaluation process before award. The proposed rule would, however, *discourage* COs from dealing with OCIs as a *technical evaluation factor*, for by doing so, a CO would risk opening discussions—and thus risk triggering a bid protest, if those discussions could not be held appropriately. As a result, the proposed rule instead in effect *encourages* contracting officials to assess OCIs much like any matter of contractor qualification, i.e., to review whether the apparent awardee can indeed resolve any open OCI issues before making award.

- **New Labels, Old Categories:** Although the proposed rule abandons the traditional categories of OCIs, focusing instead on OCIs that threaten to undermine the competitive process versus those that merely pose business risks to the Government, as Table 1 reflects, to make sense of these new legal categories, we really need to superimpose the traditional three-part taxonomy. The new nomenclature may, ultimately, only confuse things.
- **Risk Assessments—and Likely Tactics—Changed About:** The structure of the proposed new rule will mean several likely tactical shifts:
  - *Focus of Concern Reversed*: As the discussion above reflects, over approximately the past 15 years, GAO has focused closely on impaired objectivity OCIs, in part because of a fear that contractors were being asked to take on too many decision-making roles in Government. The focus of concern under the new rule has shifted to OCIs (traditionally, the biased ground rules OCIs) that may, in effect, corrupt the competitive process. This means that contractors will focus first on potential conflicts that touch on the competitive process (assisting in drafting specifications, for example), and will worry less about impaired objectivity OCIs.
  - *Firewall Rule Reversed*: The rulemakers also abandoned GAO's long-standing hostility to firewalls to mitigate impaired objectivity OCIs. Under the new rule, firewalls *are* permitted—and, indeed, the CO may simply accept the risks posed by impaired objectivity OCIs.
  - *Spectre of Postaward Clause Will Change Tactics*: Figure 1, below, shows the clauses required when there is a risk of OCIs. In a nutshell, if there is a risk of an OCI, the CO must include a warning provision, 52.203-XX, which in turn automatically triggers a clause, 52.203-ZZ, which will require ongoing *postaward* disclosures. To avoid this cascade of costs and risks, contractors will be highly incentivized to find and resolve OCIs as quickly as possible.
  - *Forgotten Stepsister—Unequal Access to Information*: Although the proposed rule shifts the provisions regarding unequal access to another part of the FAR, contractors are likely to look first to this legal "pigeonhole" for solutions. If a contractor can persuade the agency that a problem—an affiliate's access to proprietary project drawings, for example—is really a problem

Figure 2: Access to Non-Public Information—Clauses and Provisions



of *unequal access to information*, and not a full-blown OCI, the contractor will likely be able to resolve the problem simply by ensuring that those who have "released" the information for use by the Government, and those who must have "access" to the non-public information, have endorsed the appropriate "access" and "release" clauses (see Figure 2). The new hierarchy of concerns will, therefore, reshape how contractors address OCIs.

- **Overall Model Missing:** One final problem with the proposed rule is that it lacks a conceptual model, which leaves problems unanswered. Why, for example, the *volte-face*: Why are risks to the competitive process now seen as more dangerous than biased contractor advice? The answer likely lies buried in policymakers' understandings and intuitions, but those themselves can be captured by organizational models. A principal/agent model, for example, tells us that an agent's (e.g., a contractor's) conflicts of interest should cause much less concern if the agent can be closely monitored, or faces potential sanctions for transgressing. See generally Yukins, "A Versatile Prism: Assessing Procurement Law Through the Principal-Agent Model," 40 Pub. Cont. L.J. 63 (2010) (reviewing literature), *ssrn.com/abstract=1776295*. The model suggests that "biased advice" OCIs are viewed more benignly not because they are less dangerous, but because the principal buying contractor advice is really the agency (which can monitor a contractor's conflicts relatively well), while the principal assessing the integrity of the competitive process is all interested citizens (who cannot monitor contractors well, and so need more rigid protections). A conceptual model would thus explain shifts in policy, and would point the way forward for future reforms.
- **Harmonizing OCI Rules with Other Developments Internationally, and at Home:** Finally, the proposed rule makes no effort to integrate OCIs with foreign developments, such as the European Commission's interest in addressing conflicts of interest, European Commission, *Green Paper on the Modernisation of EU Public Procurement Policy—Towards a More Efficient European Procurement Market*, COM(2011) 15 final, at 49 (Brussels, 27 Jan. 2011), available at *ec.europa.eu/internal_market/consultations/docs/2011/public_procurement/20110127_COM_en.pdf*, or with the new compliance systems that contractors are rapidly developing under the requirements of FAR 52.203-13. (There is no reason, for example, why contractors could not integrate OCI surveillance into a traditional compliance system; indeed, those who must comply with contractual requirements for disclosing OCIs are likely to do just that.) To reduce trans-

action costs and improve the effectiveness of the regulatory regime, the rulemakers should look to harmonize the new rule with those parallel developments.

Conclusion—As the discussion above reflects, the proposed OCI rule marks a remarkable change in direction, in part because policymakers' core concerns—their core fears concerning conflicts of interest—have themselves shifted over time. Because new means of addressing those concerns are constantly emerging and evolving, we know that the rules will continue to evolve. We can hope, though, that as the rules advance, they will mesh more seamlessly with other advances in procurement law, both here and abroad.

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This Feature Comment was written for The Government Contractor by **Christopher R. Yukins,** ***Associate Professor of Government Contract Law & Co-Director, Government Procurement Law Program, The George Washington University Law School; of counsel, Arnold & Porter LLP.***