

# Ethics regulation of government contractors

Does extending existing ethics rules to cover government contracts solve the problem ask **Robert Rizzi**, **Charles Borden** and **Daniel Holman**

The regulation of government contractors presents a dilemma for the evolution of public ethics regimes. While the value and variety of government activities performed by contractors have grown substantially over recent decades,<sup>1</sup> rules governing financial conflicts of interests and other ethics concerns have yet to adapt this new state of affairs. As a result, contractors may increasingly be found in roles traditionally performed by civil servants without being subject to the same ethics safeguards.<sup>2</sup> While especially pronounced in the US, this mismatch in the regulation of government contractors and public servants is also an issue in the UK and in other jurisdictions.<sup>3</sup>

As highlighted below, many of the very reasons that drive governments to outsource to contractors – added flexibility, reduced costs achieved by competitive bidding, the temporary nature of the work, and the ability to adapt the structures and incentives to suit the task at hand – make it difficult to extend the existing public ethics framework to these individuals. This article reviews the current state of government contractor ethics regulations in the US, highlights certain problems inherent in the design of these rules, and suggests areas for further investigation. In doing so, we also suggest that the extension of the US federal ethics rules to government contractors may speak to the need for more fundamental changes in public ethics architecture so as to reflect the dynamic nature of the modern public workforce.

## Current US ethics regulation of government employees and contractors

In the US, federal executive branch ethics regulation of individuals is based principally on their status as employees, whether full-time or part-time.<sup>4</sup> Full-time employees of the federal government are required to make periodic financial disclosures<sup>5</sup> and are subject to prohibitions or limi-

tations with the possibility of criminal sanctions<sup>6</sup> for conflicts of interest,<sup>7</sup> earning outside income,<sup>8</sup> the receipt of gifts,<sup>9</sup> and the use of non-public information,<sup>10</sup> among others. The basic rules are tailored for special cases, for example, certain political appointees and other designated office-holders are subject to additional limitations, including a one- to two-year ‘cooling off’ period restricting post-employment conduct in the private sector,<sup>11</sup> while part-time Special Government Employees (SGEs) are more lightly regulated, notably by being permitted to hold outside employment.<sup>12</sup> However, all employees of the government are otherwise still subject to many ethics restrictions, including a prohibition on direct conflicts of interest and acting on non-public information.

In contrast, government contractors fall entirely outside of most executive branch ethics rules, with certain limited and targeted exceptions. The general provisions of the Ethics in Government Act of 1978, as amended,<sup>13</sup> the cornerstone of federal ethics regulation, do not apply to contractors because they are not ‘federal employees’.<sup>14</sup> There are certain executive branch departments and agencies where the distinction is not so stark – for example, a statute specially applies executive branch ethics laws to contractors of the Federal Deposit Insurance Corporation (FDIC).<sup>15</sup> In addition, a conflict of interest rule contained in the Federal Acquisition Regulations (FAR) prohibits ‘organizational conflicts’ by contractors involved in the procurement process.<sup>16</sup> On the whole, however, a large number of government contractor employees are not actually covered by government ethics rules, including contractors whose work responsibilities make them at times indistinguishable from government employees within the same agencies.<sup>17</sup>

US law attempts to draw a sharp line by prohibiting the outsourcing of ‘inherently governmental functions’

(IGFs) to contractors.<sup>18</sup> However, the demand for expert personnel and the difficulty of precisely defining an IGF<sup>19</sup> have diluted this distinction in practice. As a consequence of this state of affairs, individuals in a position to influence key decisions have been later revealed to have had conflicts of interest that would have disqualified their participation were it not for their contractor status. For example, Treasury Department contractor Dan Jester acted as a key negotiator in the 2008 bailout of AIG despite having substantial holdings in Goldman Sachs exposed to AIG’s potential default.<sup>20</sup> Similarly, retired Admiral Dennis Blair was president of the federally-financed defence think tank that recommended continuation of the F-22 jet fighter programme while simultaneously a board member of a major subcontractor to the F-22 programme.<sup>21</sup>

Spurred by these and other controversies, some commentators advocate expanding existing ethics rules to cover contractors, or at least to those contractors that perform IGFs or are ‘personal services’ contractors employed within federal agencies.<sup>22</sup> Other proposals would integrate ethics in the procurement process, using a mix of contractual and regulatory tools to induce compliance. In 2011, the Administrative Conference of the United States (ACUS), an independent federal agency dedicated to regulatory reform, proposed that model language prohibiting conflicts of interest and misuse of non-public information be added to the Federal Acquisition Regulation (FAR) for procurement officers to adopt on a voluntary basis.<sup>23</sup> In a similar vein, in 2014 the UK Committee for Standards in Public Life (CSPL) recommended that providers of public services be required to undertake to uphold public ethics principles as part of the contracting process, that the adequacy of contractor ethics controls be covered in certain public audits, and that identification and management of contractor ethics be made a core



element in government procurement personnel training.<sup>24</sup>

### Obstacles in the design of contractor ethics and possible solutions

Extending existing ethics rules to cover government contracts would seem to be the most straightforward solution to the problem. However, certain features of government contracting make it more difficult to apply the basic principles of government ethics regulation to contractors than to traditional executives.

ful, administrable distinctions that can be adapted to the diverse and changing worker roles, contract structures, and provider types that engage in government contracting, from custodial services firms to individuals advising high level policymakers. In other words, because the category of government contractors encompasses a variety of arrangements, from quasi-employees to one-off consultants, a single set of ethics rules is unlikely to be successful. Thirdly, the reliance on status-based categories defined by traditional employment law factors of 'control' means that a contractor's ethics obligations do not change regardless of the substance or nature of the work. The focus on control may perversely create incentives to insulate contract work from agency management, even where ethics risk factors such as the worker's responsibility, access, or discretionary authority would dictate closer supervision. Collectively, these issues make the regulation of government contractor ethics resistant to an easy solution.

Developing a regulatory structure that might address these problems requires that policymakers first agree on what the chief aim and method of regulating contractor ethics ought to be. On the one hand, ethics rules seek to prevent distortions in government decisions that could result if contractors act in furtherance of their own interests, or that of their employer's, instead of the public interest.

At the same time, these rules aim to preserve government legitimacy by avoiding the appearance of conflict that could lead to the perception of self-dealing or other violations of norms, even if no actual conflict exists. In the design of the system, policymakers need to consider whether to prioritize substantive equality between the ethics standards applied to public employees and contractors, or instead to focus on outcome efficacy, if not equality. Those concerned more about avoiding an 'appearance' of substantial conflicts and therefore indirectly concerned with public perception of legitimacy might favour the former; contractor rules need to be equally tough to avoid the perception that contracting offers a public ethics loophole. Those concerned more about preventing policy distortion might opt for a set of controls on contractors



utive branch employees. Firstly, there is the inherent 'two masters' problem that US ethics rules were originally created to address.<sup>25</sup> Because contractors work for a private employer at the same time they are providing service to the federal government by definition, conflict of interest and outside employment rules cannot be applied to contractors without significant carve-outs. Secondly, there is challenge of creating meaning-

that, while they may look and operate differently from the rules for public servants, have a similar effect in deterring abuse.

Inspiration for new models may be found in restructuring within the professional services sector, as firms in consulting, accounting, and other industries that have lessened the emphasis on hierarchy to focus on the types of services that each worker provides to clients. Contractor ethics might also feature a shift towards activity-based compliance requirements, such as are common in securities regulation.<sup>26</sup> Under this approach, ethical standards would attach to certain functions and contractual obligations – for example, involvement in procurement or providing advice to a decisionmaker – regardless of whether the work is executed by a contractor or an employee.

While this may be most logical from an ethics standpoint, designing and applying activity-based definitions with respect to the wide range of government functions would present a daunting administrative burden, and new offices or agencies would then need to be created that would have the resources and authority needed to monitor compliance and sanction failures.

Regardless of the approach taken, there is a need to assemble more comprehensive data about the number of workers employed as government contractors, the roles that they occupy within agencies, the limits placed on their activities, and the specific conflict issues that arise in those circumstances. For those agencies that have adopted ethics certifications, it would be also valuable to examine the result-

ing contractor policies and practices to assess what the burdens and benefits of these compliance practices have been, if any. Finally, the regulatory community as a whole may take this problem as an opportunity to consider whether the distinctions between categories of service providers that have driven government ethics rules in the past need to be re-imagined to better match the reality of the modern public sector.

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1 US federal contract spending grew at 12 per cent annually between 2000 and 2008 until reaching over \$500 billion in FY 2009, although spending has declined some thereafter. See 'Obama Administration succeeds in reducing contract spending for first time in 13 years', [https://www.whitehouse.gov/sites/default/files/contracting\\_reform.pdf](https://www.whitehouse.gov/sites/default/files/contracting_reform.pdf); 'Overview of awards by fiscal year', USASpending.gov, <https://www.usaspending.gov/transparency/Pages/OverviewOfAwards.aspx>

Although comprehensive information on the number of personnel employed through government contracts is lacking, the size is understood to be significant. For example, the Brookings Institution's 2002 'True size of government' study estimated 5.168 million workers employed under federal contracts, in comparison with 1.756 million civil servants. See Paul C. Light (2003), 'Fact sheet on the new true size of government', <https://wagner.nyu.edu/files/faculty/publications/lightFactTrueSize.pdf>

2 E.g. Administrative Conference Recommendation 2011-13: Compliance Standards for Government Contractors Employees – Personal Conflicts of Interest and Use of Certain Non-Public Information, Administrative Conference of the United States, pp. 3-6. 'Contractor integrity: stronger safeguards needed for contractor access to sensitive information', US Government Accountability Office, September 2010.

3 Committee on Standards in Public Life (2014), 'Ethical standards for providers of public services', London: Committee on Standards in Public Life, pp. 14-16, [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/336942/CSPL\\_EthicalStandards\\_web.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/336942/CSPL_EthicalStandards_web.pdf)

4 The distinction between government employees and government contractors in the ethics context borrows from common law employment tests, see Office of Government Ethics DAEOGram 00 x 7: 'Extent to which ethics laws and regulation apply to Federal government-private sector exchange programs' (22 August 2000), <http://www.oge.gov/OGE-Advisories/Legal-Advisories/00x7-Extent-to-Which-Ethics-Laws-and-Regulations-Apply-to-Federal-Government-Private-Sector-Exchange-Programs/> ('[The Office of Government Ethics] is not the arbiter of whether an individual is an employee, but certain factors have been developed in the context of the application of the conflict of interest statutes to aid in analyzing the issue. ... These factors address whether an individual has been appointed into the Federal service, [ ] is engaged in the authorized performance of a Federal function, and is subject to the supervision of a Federal officer or employee while engaged in the duties of his or her

position.'). Whether these borrowed tests, and the unintended results they may produce, are appropriate for the ethics regulatory context is a distinct question worthy of further research.

5 5 USC (United States Code) app §§101-111.

6 5 USC § 216.

7 18 USC § 208.

8 5 USC app §§501-505.

9 5 USC § 7353.

10 41 USC § 2101 et seq.

11 See 18 USC §§ 207(c)(3), 207(d).

12 See 18 USC § 202(a) (defining 'special government employee'); see also 18 USC §§ 203(c) and 205(c) (providing more narrow outside employment and representation rules for SGEs); § 207(c)(2) (limiting the application of post-employment bans to SGEs serving over 60 days); § 208(b) (1) and (3) (allowing conflict of interest waivers for SGEs on advisory committees); § 209(c) (exempting SGEs from the ban on outside employment).

13 PL (Public Law) 95-521, 92 Stat. 1824.

14 See USC app. 4 § 101.

15 12 USC § 1822(f); 12 CFR. Part 366. As further examples, USAID prohibits contractors from making certain investments in the country where they work (48 CFR [Code of Federal Regulations] 752.7027), the Treasury Department prohibits conflicts for TARP contractor personnel (31 CFR 31.200), and the Department of Health and Human Services maintains a conflict of interest policy for contractors in its Medicaid Integrity Audit Program (42 CFR 455.238). For a fuller discussion of agencies' contractor ethics policies, see Kathleen Clark (2011), 'Ethics for an outsourced government', St Louis MO: Washington University in St Louis, Legal Research Paper Series 11-05-03, pp. 23-31.

16 48 CFR 2.101. These organizational conflicts encompass situations in which a contractor is advising with respect to some aspect of a procurement decision in which an affiliate entity is a participant.

17 This may include 'contractors involved in the acquisition function', in which a contractor is hired to assist in the design of procurement standards and strategies or occasionally in the selection of other contractors. See 'Defense contracting: army case study delineates concerns with use of contractors as contract specialists', Government Accountability Office (2008), pp. 45-6, <http://www.gao.gov/assets/280/274007.pdf>

18 See 105 PL 270, § 5(2)(A); 112 Stat. 2382; see also 48 CFR

2.101, defining inherently governmental functions in the context of the Federal Acquisition Regulations Act (FARA).

19 See Kate M. Manuel (2014), 'Definitions of 'inherently governmental function' in the Federal procurement law and guidance', Washington DC: Congressional Research Service.

20 Clark, supra note 14, 3; see also Mark Landler and Edmund L. Andrews, 'For Treasury dept., now comes hard part of bailout', New York Times, 4 October 2008; Louise Story and Gretchen Morgenson, 'In U.S. bailout of A.I.G., forgiveness for big banks', New York Times, 29 June 2010.

21 See, e.g. R. Jeffrey Smith and Renae Merle, 'Leader of panel that endorsed jet program has ties to contractor', Washington Post, 25 July 2006, <http://www.washingtonpost.com/wp-dyn/content/article/2006/07/24/AR2006072401232.html>

22 See, e.g. Clark, supra note 14; Collin D. Swan (2012), 'Dead letter prohibitions and policy failures: applying government ethics standards to personal services contractors', George Washington Law Review 80(2): 668-702.

23 Administrative Conference Recommendation (2011-3): 'Compliance standards for government contractors employees – personal conflicts of interest and use of certain non-public information', Washington DC: Administrative Conference of the United States. <https://www.acus.gov/recommendation/compliance-standards-government-contractor-employees-personal-conflicts-interest-and>

24 Committee on Standards in Public Life (2014), 'Ethical standards for providers of public services', London: Committee on Standards in Public Life, [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/336942/CSPL\\_EthicalStandards\\_web.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/336942/CSPL_EthicalStandards_web.pdf)

25 See United States v. Mississippi Valley Generating Co., 364 US 549 (1961), ('The moral principle upon which the [federal employee criminal conflict of interest] statute is based has its foundation in the Biblical admonition that no man may serve two masters, Matt. 6:24, a maxim which is especially pertinent if one of the masters happens to be economic self-interest.')

26 See, e.g. the SEC's Municipal Adviser Rule (17 CFR § 240.15Ba1-1 et seq.) (regulating municipal advisers through a definition of 'advice'); see also the SEC's proposed rule for regulating cross-border security-based swap arrangements, 80 Fed. R. 27444 (13 May 2015), <http://www.sec.gov/news/pressrelease/2015-77.html>