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FEATURE COMMENT: Creation Of OCIs In Government Contractor Acquisition Negotiations—Can A Sufficient Mitigation Plan For OCIs Be Implemented During Confidential Deal Discussions?

As the Government contracting industry continues to consolidate and the U.S. Government continues to outsource procurement tasks to contractors, the frequency of organizational conflicts of interest is on the rise and the Government is focusing with increasing vigor on OCI regulatory compliance. The Government Accountability Office issued two decisions last month, sustaining bid protesters' arguments that negotiations between two Government contractors regarding a possible acquisition were sufficient to raise OCIs. The two decisions are *McCarthy/Hunt, JV*, B-402229.2, Feb. 16, 2010; and *B.L. Harbert-Brasfield & Gorrie, JV*, B-402229, Feb. 16, 2010. At the heart of the GAO analysis was the focus on the *potential* for competitive advantage or bias, and the view that if the Government agency's contracting officer is not informed of a potential acquisition and actively involved in the parties' proposed OCI mitigation plans prior to onset of negotiations and due diligence between the parties, a party can risk losing a contract award.

Acquisition discussions, by business necessity, are typically carried out under tight confidentiality, with the deal negotiations and due diligence conducted by a limited in-house team and outside advisors. The personnel in the acquiror and the target company who would be familiar with their respective existing contracts or active procurement efforts that could give rise to an OCI may very well not be part of their companies' deal teams. As a result, it is often only well into the deal due diligence process that the parties connect the dots for potential OCIs. The recent GAO decisions suggest that may be too late to mitigate an OCI and avoid tainting the procurement process—even if the deal is not consummated.

This Feature Comment briefly lays out the OCI regulatory framework, describes the recent GAO decisions, and discusses certain issues that arise for companies in trying to comply with the OCI regulatory requirements in an acquisition context.

OCI Framework—An "organizational conflict of interest," as defined in § 2.101 of the Federal Acquisition Regulation,

> means that because of other activities or relationships with other persons, a person is unable *or potentially unable* to render impartial assistance or advice to the Government, or the person's objectivity in performing the contract work is *or might be* otherwise impaired, or a person has an unfair competitive advantage.

(Emphasis added.) FAR subpt. 9.5 provides further guidance on OCIs. The two underlying principles to identify and resolve OCIs are (1) preventing the existence of conflicting roles that might bias a contractor's judgment and (2) preventing unfair competitive advantage. FAR 9.505. The situations in which OCIs can arise are categorized into three broad groups: (a) unequal access to information, (b) biased ground rules and (c) impaired objectivity. *Aetna Gov't Health Plans, Inc.; Found. Health Fed. Servs., Inc.*, Comp. Gen. Dec. B-254397, 95-2 CPD ¶ 129.

The first category of OCIs involves circumstances in which a company has access to nonpublic information in performing a Government contract that may give the company a competitive advantage in a later competition for a Government contract. Bias is not an element in establishing this type of OCI. The second category of OCIs focuses on the concerns that a company may, by participating in the process of setting procurement ground rules, skew the competition (intentionally or unintentionally) in its favor, and that by virtue of its special knowledge of the agency's future requirements, may have an unfair advantage in the procurement process. The third category involves OCIs in which a company's work under one Government contract may entail evaluating itself, either through an assessment of its performance under another existing contract or in an evaluation of proposals for a new contract. Id. As noted above, in the definition in FAR 2.101, an OCI may result if factors create an "actual or potential" conflict of interest. FAR 9.502(c). *Aetna*, a seminal OCI decision, noted that a key purpose of FAR subpt. 9.5 is to avoid the appearance of impropriety, and that harm and prejudice are presumed if an OCI (other than of a de minimus nature) is not resolved.

In addition to the breadth of the regulatory requirement raised by the potentiality prong, case law has interpreted the regulations to cover conflicts of a more indirect nature through corporate and contractual affiliations. In *Aetna*, the U.S. Comptroller General reasoned that,

> [w]hile FAR subpart 9.5 does not explicitly address the role of affiliates in the various types of organizational conflicts of interest, there is no basis to distinguish between a firm and its affiliates, at least where concerns about potentially biased ground rules and impaired objectivity are at issue.

However, the opinion did say that "a 'Chinese wall' arrangement may resolve an 'unfair access to information' conflict of interest." In *Aetna*, the Comp. Gen. found a significant OCI existed because an affiliate of a major subcontractor was evaluating a proposal submitted by the prime contractor, even though there was severance of communications between the affiliates and there was no direct financial interest of the affiliate's employees performing the evaluation services for the agency.

FAR 9.504 provides that it is the agency CO's responsibility to avoid, neutralize or mitigate significant potential conflicts before contract award. The CO is required to identify and evaluate potential OCIs "as early in the acquisition process as possible," and avoid, neutralize or mitigate significant potential conflicts before contract award. FAR 9.504(a). Acquisition in the preceding sentence refers to contract procurement, not to acquisitions of one company by another.

Recent GAO Decisions—The two recent GAO decisions, *McCarthy/Hunt, JV*, and *B.L. Harbert-Brasfield & Gorrie, JV* ("*Harbert/Gorrie*," and together with *McCarthy/Hunt*, the "AECOM decisions"), arose under the same procurement. At issue was an Army Corps of Engineers procurement for the design and construction of a Government hospital at Fort Benning, Ga.

Parties Involved in the Procurement: In June 2007, the Corps awarded a contract to HSMM/HOK Martin Hospital Joint Venture (the "Consultant") to assist the Corps with the preparation of both the design concept for the hospital and a technical review of the proposals submitted. The procurement was conducted in two phases. In June 2008, the Corps issued the Phase I solicitation for the contract. Four firms responded to the request for proposals for the project, with three firms making it to the second phase of the procurement selection process: (1) McCarthy/Hunt; (2) Harbert/Gorrie; and (3) Turner Construction Company, Inc. and its design partner and proposed subcontractor for the project, Ellerbe Becket ("EB," and together with Turner, "Turner/EB"). In May 2008, one month before the issuance of the Phase I solicitation, the Consultant's parent company, AECOM Technology Corp., executed a confidentiality agreement with EB regarding AECOM's possible acquisition of EB.

AECOM Executive's Knowledge of Possible OCI: In August 2008, an AECOM senior vice president in charge of the Consultant attended an industry forum held by the Corps about the upcoming hospital contract, and noticed that EB had expressed an interest in the project. The AECOM executive had learned a month earlier that AECOM had been in confidential negotiations to acquire EB. After the forum, the executive asked his AECOM supervisor about the potential for a conflict of interest if AECOM acquired EB, but the supervisor indicated that negotiations with EB "had not been productive." AECOM did not communicate any concern to the Corps. A few weeks later, the AECOM executive learned that AECOM's negotiations with EB had been suspended, and he believed there was no further potential conflict. According to the Corps' senior project manager, he exchanged e-mails regarding potential OCIs of the bidders on the project with the AECOM executive, who said he had "inquired with several offices involved in the [Consultant] and reported only teaming relationships."

Award of Contract and Announcement of Acquisition: The AECOM executive represented that around

April 2009, the Consultant concluded its work preparing the Phase II solicitation and that to the best of his knowledge, AECOM was not in negotiations with EB at that time. The Corps' technical review board, with the Consultant's participation and support, completed its work in July 2009, and toward the end of August 2009, the source selection authority decided to award the contract to Turner/EB. The Corps made award on Sept. 28, 2009. On Oct. 7, 2009, EB's board of directors approved the acquisition by AECOM, obtaining shareholder approval for the acquisition on October 22 and announcing the acquisition on Oct. 23, 2009.

CO's Assessment of OCI: The CO reported that she first learned from the Corps program manager that one of the bidders' subcontractors was in acquisition negotiations with AECOM on July 21, 2009, the month in which the Corps' technical review board and the Consultant concluded their analysis. The Corps program manager indicated to the CO that he was bound by an AECOM confidentiality agreement and, thus, could not disclose the name of the subcontractor. The AECOM executive indicated to the CO that he was the only person on the Consultant technical evaluation team who was aware of the confidential negotiations with EB. The CO noted that she considered the fact that AECOM's negotiations were with a potential subcontractor of a bidder, not the bidder itself. She determined that the AECOM executive had not reviewed the proposal and that his recusal from involvement with the technical review board would avoid any potential conflict of interest. The CO's memorandum of record memorializing the meetings and events of July 21, 2009, did not mention that (a) the information she received from the AECOM executive indicated AECOM's interest in acquiring EB predated the Corps' industry forum and (b) AECOM learned of the possibility of a conflict of interest at the industry forum.

Basis of Protest—The protester in *McCarthy/Hunt* alleged that Turner/EB had each of the three types of OCIs (unequal access to information, biased ground rules and impaired objectivity). In *Harbert/Gorrie*, the protester alleged only unequal access to information and biased ground rules. GAO sustained the allegations that Turner/EB had unequal access to information and a biased ground rules OCI, and recommended that Turner/EB be eliminated from the competition and that the protesters be reimbursed reasonable costs of filing and pursuing the protest, including reasonable attorneys fees. GAO rejected the impaired objectivity claim.

Turner, as contract awardee, intervened in both protests. At the outset of its analysis, GAO noted that Turner's primary argument against the OCIs was that the relationship between AECOM and EB "was too attenuated … until the acquisition was completed." In rejecting that argument, GAO noted that as early as the industry forum in August 2008, "AECOM's and EB's interests effectively were aligned as a result of the merger/acquisition discussions sufficient to present at least a potential organizational conflict of interest." GAO explained that the fact that negotiations between the companies may not have been continuous or stretched over an extended period of time did not allay the potential conflict. Noting that the negotiations occurred during active phases of the procurement, GAO found the relationship between the firms sufficiently close to give rise to an OCI.

Unequal Access—As noted above, GAO's analysis of whether an unequal access OCI existed focused on the *potential* for access to information, not on whether AECOM or EB personnel actually obtained access to information. In finding that such potential access existed, GAO noted that an unequal access OCI may be mitigated through the implementation of an effective mitigation plan, but ultimately determined that there was no effective plan here. GAO's criticism of the parties' mitigation efforts focused on two issues: (1) the deficiencies of the access restrictions themselves, and (2) the lack of involvement of the CO in crafting the mitigation plan.

Disclosure within AECOM of EB Information; Self-Executing Mitigation Plans Not Sufficient: AECOM's assistant general counsel, who advised AECOM in its negotiations with EB, argued that AECOM had in place a number of protections, which, taken together, mitigated any unequal access OCI. He noted the existence of the confidentiality agreement between the parties, which permitted AECOM to disclose proprietary information of EB within AECOM and with its agents only on a need-to-know basis, and required AECOM to obtain written consent from EB prior to disclosing to any third party the fact that the two parties had exchanged confidential information. He also noted that to maintain confidentiality, the potential acquisition was referred to within AECOM solely by its code name, "Project PACE." He estimated that 25 to 30 in-house personnel were involved in the due diligence review. It was also noted that five

AECOM employees, possibly not part of those individuals included in the due diligence reviews, attended EB management briefings. GAO noted that there was no indication of how many employees fit the need-to-know category, who they were or how their need to know was determined.

GAO concluded,

> However many AECOM employees fit the definition of 'need to know,' the record contains no evidence of an effective plan, that was disclosed to and approved by the contracting officer and subject to monitoring by her, to ensure that information regarding AECOM's plans to acquire EB was kept confidential.

Consistent with FAR 9.504's requirement that the CO is responsible for avoiding, neutralizing or mitigating significant potential conflicts before contract award, GAO noted that the contemporaneous record contained no indication that the CO relied on or was even aware of AECOM's arrangements and that, in any event,

> it would be unreasonable for the agency to rely on a de facto mitigation plan—namely, the assurance that the negotiations had and would only involve AECOM employees who would keep that information confidential—when, as discussed above, the efforts to maintain confidentiality were largely undisclosed to, unevaluated by, and unmonitored by the Corps—in a word, self-executing.

Disclosure of AECOM Corps Work to EB: The Corps identified 49 AECOM employees who worked on the design contract and, thus, who may have had access to competitively useful information. In the protest proceedings, 42 of those employees gave declarations stating that they had no knowledge of the acquisition negotiations and had no reason to improperly influence the procurement. The decision noted that only one of the 42 declarants expressly stated that he did not discuss the procurement with anyone at EB, and seven of the 49 did not submit any declarations.

GAO also presumed that the 49 AECOM employees used e-mail in conducting their work for the Corps, but noted that, although AECOM affiliates outside of the Consultant did not automatically have access rights to data on the Consultant's servers by virtue of their employment, it saw no evidence anywhere in the record that there were specific efforts to limit access by others to such e-mail. Focusing on the various ways in which AECOM and EB personnel might have had access to each other's information, GAO concluded,

> [W]ith respect to the AECOM employees who worked on the design contract, without credible evidence that AECOM had systems in place to prevent the receipt of competitively useful information by EB, there is no reasonable basis to assume that the information was not made available to EB employees.

Biased Ground Rules—Although an unequal access OCI does not require any element of bias, GAO found that the same facts that resulted in an unequal access OCI evidenced that AECOM had special knowledge of the Corps' requirements that would have enabled it to give Turner/EB an unfair advantage in the competition. GAO noted that there was no evidence that the Corps closely supervised AECOM, but suggested that even if it had, it would be unreasonable to assume such supervision would prevent AECOM from using its special knowledge to benefit Turner/EB unfairly. Importantly, in discounting the argument that there was no evidence AECOM actually skewed the competition to benefit Turner/EB, GAO emphasized that the analysis was whether a company "was in a position to affect the competition, intentionally or not, in favor of itself," and that if a conflict exists, the standard to be used is a rebuttable *presumption* of prejudice. Among other defenses, Turner argued that at all times during the solicitation development, AECOM and EB were not in fruitful negotiations, and, thus, the AECOM employees assisting the Corps on the procurement had no knowledge of AECOM's interest in EB. In rejecting this argument, GAO reiterated the lack of process undertaken by AECOM in determining which of its employees had a need to know of the negotiation and how confidentiality was ensured, and suggested that AECOM did not have systems in place to wall off AECOM employees who had a need to know from other AECOM employees not on the deal team.

Impaired Objectivity—Only the *McCarthy/Hunt* protest raised an impaired objectivity OCI claim, which, as noted above, involves a situation in which a firm's work under one Government contract could result in its evaluation of itself with respect to another contract. In this instance, GAO agreed with the Corps and Turner that the record demonstrated a lack of prejudice. As with a biased ground rules OCI analysis, an impaired objectivity OCI analysis involves a rebuttable *presumption* of prejudice if an

OCI is found to exist. GAO found that on the record, the Consultant evaluators were more critical of the Turner/EB proposal than others and, as a result, there was no reasonable basis to conclude they were biased in awarding the contract to Turner/EB.

Mitigating OCIs in a Deal Context—Given the increasing likelihood of OCIs in the Government contractor industry and the Government's increasing focus on OCI compliance, contractors need to be particularly sensitive to this issue before entering into acquisition discussions. As noted above, in analyzing both the unequal access OCI and biased ground rules OCI claims, the AECOM decisions focused on the need for identification of potential OCIs, and precision in crafting, and follow through in implementing, any OCI mitigation plan, including the need to involve the CO as early as possible in crafting the mitigation plan.

There is a bit of a "chicken and the egg" issue in the acquisition context. It is most likely only through the parties' diligence of their respective businesses that they may uncover a situation giving rise to an OCI. However, GAO is insisting that the mitigation plan needs to be in place on the front end, before the parties' discussions and information exchanges creating the potential for unequal access or bias arise. There are other practical considerations. For example, how can parties keep deal teams small enough to ensure confidentiality while at the same time have the manpower necessary to uncover potential OCI issues early in the process? Acquisition negotiations often occur under tight time constraints, particularly in an auction context. It is challenging for a small team operating under significant time constraints to identify potential OCIs early in the process.

Would a customary confidentiality agreement permit disclosure of the potential deal by a party to its COs? Also, contractors often have many agency contacts with many COs. Perhaps disclosure could be to those COs for pending proposals (i.e., pre-award). This, however, still leaves unanswered the question of how quickly potential OCIs relating to pending proposals are identified for disclosure to the COs.

Some practical suggestions:

Contractors should consider adopting an internal OCI policy specifically for acquisitions that includes detailed guidance on how deal teams should be comprised and how information regarding the counterparty should be secured within the company. Parties may want to consider using "clean teams" for certain aspects of the diligence if the risk of an OCI is more likely to occur. Clean teams are often use in M&A deals that involve antitrust concerns. The teams, typically consisting of a limited number of executives from the two parties and outside advisors, conduct an analysis of competitive and other confidential data to assess the benefits of the transaction, and then report that information in a way that does not risk regulatory problems—usually an aggregated, summary format. See *Omnicare, Inc. v. United Healthcare, Inc.*, 594 F. Supp. 2d 945 (N.D. Ill. 2009), in which the court addressed due diligence clean team constructs.

Also, how that information is transmitted and maintained internally, in hard copy and on computer servers, should be addressed. The March 2008 GAO report, *Army Case Study Delineates Concerns with use of Contractors and Contractor Specialists* (GAO-08-360), although not focused on OCIs arising in acquisition negotiations, describes a number of OCI mitigation plan elements, some of which touch on points similar to the suggestions noted here. Note, although mitigation plans may be effective for addressing some OCIs, GAO has noted that other OCIs, because of their nature, are unmitigable. *Aetna*.

Contractors should revisit their form confidentiality agreements for acquisitions. Contractors should consider whether to include more specificity to the customary need-to-know language in the agreement (though detailed procedures may be better left to internal policies of the companies). In addition, a company does not want put itself in the position of potentially breaching a confidentiality agreement by making disclosures to a CO. Thus, consider broadening the disclosure exceptions to specifically permit disclosures to the companies' COs (or at least those COs at agencies where there are pending bids) in connection with OCI issues. The federal Trade Secrets Act, 18 USCA § 1905, prohibits federal officials and employees such as COs from disclosing companies' proprietary information that they learn in the course of their official duties or employment. The FAR contains guidance on the labeling and other steps that a contractor must take to avail itself of the protections under the Act.

Coordinate OCI mitigation procedures with the other party at the outset. Contractors considering an acquisition transaction should discuss at the outset their respective procedures to address possible OCIs to ensure consistency in approach by their respective deal teams. This discussion should be held no later than the time the confidentiality agreement is negotiated.

Communicate to the CO. The AECOM decisions made it very clear that GAO believes contractors cannot, on their own, create sufficient OCI mitigation plans. For any mitigation plan to pass muster, the relevant COs need to be included in developing that plan—and their involvement needs to happen at an early stage. One possible approach is for a company to vet a proposed framework for a standard mitigation plan with the relevant COs prior to any specific deal being identified. Such a plan could include the concepts similar to those suggested above. Then, if the parties become aware of a potential OCI in a particular proposed transaction and the COs are apprised of this, the COs and the company can work together to implement any further protections deemed appropriate.

Consider requiring divestiture of problematic contracts pre-closing. The acquiring company should consider whether it is feasible in the context of the target's overall contract portfolio and the business goals of the transaction to include in the acquisition agreement a requirement that the target divest the problematic contracts as a condition to closing. Having such a closing condition is not a new concept in OCI mitigation. The AECOM decisions noted that the financial interests of the negotiating parties were aligned as early as the industry forum, when the AECOM executive became aware of EB's interest in participating in the procurement process. Pulling out the value of that contract from the deal addresses that financial alignment. Defense contractors have divested or are in the process of divesting their existing consulting/systems engineering and technical assistance (SETA) businesses to meet OCI regulatory requirements. Note, for example, Northrop Grumman Corp.'s December 2009 sale of TASC, Inc. to Kohlberg, Kravis, Roberts & Co. and General Atlantic. Financial buyers, such as private equity firms, whose portfolio companies do not include other Government contractors (or at least other Government contractors whose business does not go beyond consulting/SETA work such that they would be in a position to bid on programs created through such consulting work), are well positioned to acquire these businesses. However, given that affiliates are swept into the OCI analysis, even these financial players must be vigilant to ensure that their existing portfolio companies are not looking to expand into work that will create an OCI problem, and must keep these OCI issues in mind when identifying potential new targets for their portfolios. Thus, both strategic and financial acquirors should consider implementing acquisition OCI policies for acquisition negotiations and due diligence.

New Regulatory Guidance on the Horizon—New OCI regulations were scheduled to be issued at the end of 2009. As of the date of this article, they have yet to be released. It is not expected that the new rules will address the specific issues present in the acquisition context. In the absence of additional regulatory guidance, contractors should consider carefully the issues raised by the AECOM decisions when contemplating potential acquisitions.

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This Feature Comment was written for The Government Contractor by* Sarah E. Kahn*, a partner at Arnold & Porter, LLP. She focuses her practice in the area of mergers and acquisitions in the Government contracting industry. Ms. Kahn was named the 2009 Top Washington Lawyer Corporate M&A by the* Washington Business Journal *and has also been recognized by* The Legal 500 US *2009 for her M&A work. Arnold & Porter, LLP represented the protester in one of the proceedings discussed in this article (*McCarthy/Hunt*). Ms. Kahn had no involvement in that representation.