

MERCATUS CENTER

GEORGE MASON UNIVERSITY

REGULATORY STUDIES PROGRAM

Public Interest Comment on Federal Acquisition Regulation; Contractor Responsibility, Labor Relations Cost, and Costs Relating to Legal and Other Proceedings- Revocation¹

The Regulatory Studies Program (RSP) of the Mercatus Center at George Mason University is dedicated to advancing knowledge of the impact of regulation on society. As part of its mission, RSP conducts careful and independent analyses employing contemporary economic scholarship to assess rulemaking proposals from the perspective of the public interest. Thus, this comment on the Federal Acquisition Regulatory Council Revocation of the December 20, 2000 final rule on Contractor Responsibility does not represent the views of any particular affected party or special interest group, but is designed to evaluate the effect of the Agency's proposals on overall consumer welfare.

On April 3, 2001 (66 FR 17758) the Federal Acquisition Regulatory (FAR) Council proposed a revocation of the December 20, 2000 rule on the issues of contractor responsibility and costs related to labor relations and legal proceedings for federal contractors. Although addressing a number of concerns, the primary focus of the rule, as well as the proposed revocation of the rule, is a redefinition of the process of granting federal contracts based on the potential contractor's record of business responsibility. Concurrently with the proposal to revoke this rule, the FAR Council published an interim rule that places a 270-day stay on the implementation of the December 20, 2000 rule, which was to have taken effect January 19, 2001.

I. Introduction

The primary focus of the changes to the Federal Acquisition Regulations contained in the final rule published December 20, 2000 (65 FR 80256) is on redefining the rules surrounding contractor responsibility as outlined at FAR Part 9.² The rule establishes a

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² The major changes to contractor responsibility qualifications are to FAR 9.103 and 9.104. Other changes are to FAR Parts 14, 15, 31, and 52.

new standard for the determination of contractor responsibility in government contracting that is both unclear and unneeded. It dramatically increases the range of legal and regulatory matters that contracting agents must consider and act upon without establishing clear rules for them to follow. Furthermore, it applies this extensive and complicated fix to a procurement system that effectively appears to bar undesirable parties from being granted government contracts, and in doing so replaces the existing system with an inferior one. Finally, the rule clearly does not pass a cost-benefit test.

These, and a number of other issues surrounding the rule, indicate that this proposed rule to rescind the changes to procurement policy is both necessary and appropriate. First, the proposed rule will revoke an unclear and potentially costly federal regulation that will not achieve its stated purpose. And second, the proposed rule will return the Federal Acquisition Regulations to their prior state, one that was by all accounts working as intended to disallow bad actors from obtaining government contracts.

II. Basis for the Revocation of the Final Rule

The text of the April 3, 2001 proposed rule to revoke the final rule on contractor responsibility states the following:

[I]t is not clear to the FAR Council that there is a justification for including the added categories of covered laws in the rule and its implementing certification, that the rule provides contracting officers with sufficient guidelines to prevent arbitrary or otherwise abusive implementation, or that the final rule is justified from a cost benefit perspective. (66 FR 17758)

This quotation outlines three key flaws with the final rule, and while the proposed rule to revoke does not review the rationale behind these claims in depth, it seems that the FAR Council has reviewed and understood the issues raised by commenters on the final rule and agrees with their assessment. These three flaws in the December 20, 2000 rule form a more than adequate basis for revocation of the rule from a public interest perspective. In fact, any one of these three flaws alone should be considered grounds for reconsideration and possible reworking of a rule in order to protect the public interest from poorly designed, wasteful, and inefficient public policy.

There is a longstanding statutory requirement in the Federal Acquisition Regulations that firms contracting with government agencies have a record of responsible business conduct. This serves to protect the government, and ultimately taxpayers, from dealings with unscrupulous businesses. The purported rationale for the final rule was to clarify the statutory requirements of ‘integrity and business ethics’ for government contracting. The result of the final rule, however, was to add uncertainty and apprehension to a process that was already clear and working smoothly.

Prior to the December 20 final rule, the requirements for business ethics and integrity related to specific offenses that directly affected a firm’s contracting performance. Contracting or purchasing agents in the federal government agencies soliciting bids are

responsible for reviewing an offeror's record to determine whether the firm has been guilty of a number of offenses, including fraud, embezzlement, theft, and various manipulations or falsifications of records, all of which relate to contract performance. Because these criminal acts directly affect the other party to the contract, they should be taken into account when a purchasing officer makes a determination of the offeror's ability to perform the contract.

The December 20 final rule significantly extends this list of potential offenses to include a number of regulatory violations that have little impact on contract performance. These modifications to contracting policy are not well conceived and are potentially costly. Pursuant to the final rule, contracting agents would be required to examine the records of offerors in the areas of labor and employment, environmental, antitrust, tax, and consumer protection laws.

In addition, and potentially more problematic, the final rule states that contracting officers should look not only at offenses for which offerors have been found guilty, but also pending accusations and even administrative complaints by the various federal agencies. Although the rule advises agents to consider convictions more heavily than complaints, it provides no clear rule as to how to weight them in a decision. The end result is a contractor responsibility determination made by an agent untrained in administrative law who must make a ruling on regulatory and legal issues that in some cases have resolutions pending elsewhere in the legal system. This could raise the question of violation of due process.

Additionally, the inclusion of the added categories of covered laws duplicates and complicates existing remedies for dealing with firms that violate regulatory mandates. Separate from the acquisition process is a government-wide system for debarment and suspension of firms that are grossly or routinely out of compliance with government regulations. However, the debarment and suspension system operates through a separate, and formal channel where the agencies responsible for executing the various regulations bring charges of noncompliance and seek debarment or suspension. Under this system, accused firms may present evidence in their defense in hearings. The language of the final rule would appear to grant the equivalent of debarment powers to procurement officers because findings of non-responsibility based on regulatory compliance records may last for up to three years. This would mean firms might be debarred in all but name without going through the statutory debarment process.

Placing *de facto* debarment decisions in the hands of procurement agents could result in findings of non-responsibility that are unclear, inconsistent, and arbitrary. Furthermore, the regulatory areas that the rule directs agents to consider have, for the most part, nothing to do with the offeror's ability to perform the contract. The rule extends the power of contracting agents and confuses their decision criteria by overriding the underlying principle that contracts should be awarded to the low bidder unless a rational basis is presented for declining the contract to the low bidder.

According to the existing regulation, the procurement agent was responsible for denying a contract based on evidence that the bidder could not perform the necessary actions or

that there was evidence that they were a risk because of past illegal behavior directly related to contracting or business practice. By removing the necessity to link contract denial with contract performance, the rule opens the door to politically motivated government contracting. Any complaint against a bidder, whether substantiated or not, for violation of, for example, a labor law dealing with unionization, is a basis for contract denial on the grounds of contractor non-responsibility.

Even in the absence of political influence, the discretion left to the contracting official means that these determinations will most likely be inconsistent and arbitrary because of the lack of any kind of guideline or rule as to implementation. Moreover, even assuming that all contracting officers always act in the best interest of the government, this rule opens the door to accusations of political influence over contracts by parties with incentives to reverse or change a contracting decision for their own financial or political gain. Prior reforms in government contracting have been aimed at reducing even the perception of political influence to avoid such controversy. It seems that the final rule embodies a regression in policy reform.

In addition to extending responsibility determinations to unrelated issues and not erecting a proper framework with clear rules to guide determinations, the final rule addresses a nonexistent problem in government contracting. The existing rules concerning contractor responsibility are performing as intended, and a government-wide debarment process, designed specifically for this purpose, already handles any issues related to regulatory compliance. These new regulations would circumvent established procedures and practices by substituting the judgment of the procurement agent.

This raises the question of why the final rule was ever proposed and what its intent was. Although the official language in the rule states that its purpose is merely to clarify the statutory requirement that contractors have a “satisfactory record of integrity and business ethics,” the government agencies that routinely use the procurement process, including GSA, which has a presence on the FAR Council, faulted the final rule as unnecessary and ill conceived. It stated that not only was the rule not needed, but that it would erode progress in recent years to streamline the procurement process.³ EPA stated strongly that the current rules and processes for ensuring that the government deals with responsible businesses did not need fixing.⁴

III. Costs and Benefits of the Regulation

The final rule published December 20, 2000 imposes significant costs on both potential federal contractors and the government, which ultimately means taxpayers, while producing no identifiable benefits. By revoking the final rule, the proposed rule of April 3, 2001 avoids the costs associated with the final rule. While the final rule would have

³ GSA Acquisition Policy Division Memorandum, GSA Comments: FAR Case 1999-010 (Contractor Responsibility) (99-010-221).

⁴ EPA Office of Acquisition Management letter to FAR Secretariat (99-010-244).

failed a strict cost-benefit analysis were one conducted by the FAR Council, the proposed rule to revoke clearly passes simply on the basis of avoiding the additional costs that carry no benefits.

The costs associated with the final rule are twofold: first, an increase in paperwork cost, documented in the published rule, and second, the large increase in the cost of federal contracting likely to result from the new restrictions. The final rule estimated the paperwork burden for contract bidders would increase by 505,000 hours annually, which represents a 550% increase over the *status quo* for contractor responsibility paperwork. The massive increase in paperwork costs identified in the final rule is the result of a significant increase in the number and complexity of documents to be filed with each and every contract bid. All of the new regulatory areas to be considered in business responsibility decisions require paperwork to be filed by the bidder concerning the bidding firm's record of compliance. This increase imposes costs on the bidder as well as the federal government procurement agents that are required to process and act on the information. Furthermore, despite the immense size of the additional paperwork burden, it is probably understated. The FAR Council states that only 3 hours of paperwork are required for initial filings and as little as 0.5 hours for follow-up clarifications. For large multinational firms it is unlikely that they can assess regulatory compliance records for all business units in 3 hours.⁵

Further concern over the paperwork burden results from the fact that the paperwork required for each contract bid includes sworn statements concerning regulatory compliance in the areas named in FAR 9.104-1. Because of the multitude and complexity of regulations included, the costs imposed on even modest-sized firms to verify this information are large. In addition to the filing costs, falsifications on these forms, even ones that result from honest mistakes and oversight due to the above-mentioned breadth and complexity of government regulations, carry criminal penalties and massive fines. This alone will serve to dissuade many firms from seeking government contracts.

Of potentially greater magnitude than the paperwork costs are the increased costs of the procurement process to contractors and the government. By raising further barriers to securing government contracts, many potential contractors may be driven out of the market. Small firms will be even more likely to avoid government contracting opportunities, especially when contracts may be held up because of myriad regulatory entanglements. Because of the inconsistency and uncertainty of enforcement by contracting agents, these rules are likely to lengthen the contracting process formidably, and to raise legal issues that may lead many government contracts into litigation. Any low bidder denied a contract for non-responsibility would likely seek recompense in the

⁵ The National Alliance Against Blacklisting cites the FAR Council assessment, issued with the Proposed Rule in the Paperwork Reduction Act analysis, that the new requirements for reporting would result in an additional 10 million hours of paperwork. It estimates that this would impose a cost on contractors of nearly \$500 million annually. The increase in work hours for federal contracting agents was estimated at 2.5 million hours, resulting in costs of an additional \$100 million to taxpayers.

courts, particularly when inconsistent judgments by contracting officers result in bidders with similar or worse records being granted contracts.

IV. Conclusion and Recommendation

The FAR Council's proposed rule to revoke the final rule on contractor responsibility is in the best interest of American taxpayers, and businesses. The final rule was ill conceived and did not accomplish its stated purpose. If implemented, it would have eroded recent improvements made in the procurement process.

Problems with the December 20, 2000 rule are threefold. First, because existing rules for contractor responsibility and a separate process of debarment are superior remedies for contractor misconduct, the final rule is unnecessary. Second, the expansion of contractor responsibility determinations carries no clear guidelines for the contracting officers charged with executing the policy. This could lead to irregular and inconsistent application of the rules, thereby reducing the effectiveness and fairness of the procurement process at best and introducing political manipulations at worst. By transferring authority to enforce and punish federal regulatory laws to contracting officers, the proposed rule violates due process considerations. Accused parties may have no chance to respond to charges against them before punishment (i.e. denial of contract) is carried out. Finally, implementation of the final rule would increase the costs of government procurement both to contract bidders and to the government, which ultimately means to the taxpaying public. Costs would be incurred in paperwork and administration as well as inefficiencies and legal actions. Paperwork costs alone may be as high as \$500 million annually by some estimates.

For the above reasons, the move to revoke the December 20, 2000 changes to the Federal Acquisition Regulations is beneficial to the public at large. The final rule is worse than the *status quo* at achieving its stated purpose and fails any reasonable cost-benefit analysis. Indeed, there are no identifiable benefits related to the rule, only considerable costs. Because the proposed rule restores the *status quo ante* it is clearly beneficial. Based on the above analysis, there appear to be no costs, only benefits, to restoring the Federal Acquisitions Regulations to the state prior to the final rule.