

UNITED STATES GENERAL ACCOUNTING OFFICE

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STATEMENT OF H. L. KRIEGER
DIRECTOR, FEDERAL PERSONNEL AND COMPENSATION DIVISION
BEFORE THE
SUBCOMMITTEE ON OVERSIGHT AND INVESTIGATION
OF THE
HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
ON
[POTENTIAL CONFLICTS OF INTEREST IN CONTRACTING
FOR REGULATORY ANALYSIS]

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Mr. Chairman and Members of the Subcommittee:

GAO welcomes the opportunity today to discuss our work relating to your inquiry into potential conflicts of interest. You specifically expressed concern over the use and misuse of a cost-benefit analysis as a regulatory decisionmaking tool. You also raised the question of potential conflicts of interest which may arise when consulting firms, employed by Federal agencies to do regulatory analyses, also perform similar studies for the industry subject to regulation.

Your inquiry defined a potential conflict of interest as any instance where:

- The contractor has performed studies in related areas for the regulated industry.
- The principal investigators of the consulting firms have performed studies in related areas for the regulated industry.
- The principal investigators for the consulting firms have been recently employed by companies in the regulated industry.
- A contractor, expert consultant, or principal investigator of a consulting firm who are performing studies commissioned by the agency have testified on behalf of the regulated industry in any enforcement action or rulemaking procedure.

In our opinion each of the above categorizations could represent a situation whereby a conflict of interest could occur. However, the identification of a potentially conflicting situation does not necessarily mean that a conflict of interest actually exists. There is at times a valid need to obtain the expertise of knowledgeable individuals to assist in improving the many varied operations and activities of the Federal Government. We believe that if agencies see a need for this resource they should take specific steps to evaluate the risk of adverse impact from either a potential or actual conflict of interest and take steps to deal with this risk.

You requested that we analyze contracts at the following executive departments and agencies and the independent regulatory commissions to identify situations which meet the above definition of potential conflict of interest:

- 24--Environmental Protection Agency (EPA).
- 425--National Highway Traffic Safety Administration (NHTSA).
- 912--Department of Energy (DOE).
- AGC01452--Federal Energy Regulatory Commission (FERC).
- 71--Federal Communications Commission (FCC).
- 73--Consumer Product Safety Commission (CPSC).

You further requested that we identify the policies and procedures used by each organization to identify conflicts of interest involving contractors.

To satisfy your request, we analyzed 152 contracts awarded by the above organizations (excluding CPSC) since 1977. We also examined 4 contracts awarded by CPSC since 1975. Most of these 156 contracts were selected from listings of contracts awarded to support regulatory analyses that each organization provided to your committee. These contracts do not represent the total number of contracts awarded for regulatory analyses, and we did not attempt to identify the total number.

Our analysis of the contracts was limited to examining the basic contract documents and the company proposals which are normally part of the contract file. We also reviewed any relevant correspondence that pertained to an agency's decisions regarding conflict of interest. We did not evaluate an agency's actions for dealing with a potential conflict of interest or any decision regarding the award of a contract. At your staff's request, we did not obtain comments regarding the results of our work.

In our analysis of contract files at the 6 organizations, we identified potential conflict-of-interest situations in 101 of the 156 contracts. The situations we found are categorized as follows:

--90 contracts where the contractor identified similar studies it had performed for the regulated industry,

--68 contracts where the principal investigators had performed similar work for the regulated industry,

--43 contracts where the principal investigators had been recently employed by firms in the regulated industry, and

--12 contracts where the company, an expert consultant, or the principal investigators have represented firms in the regulated industry in any enforcement action or rulemaking procedure.

In addition, we found 11 contracts that had been awarded to companies that are manufacturers of products in the regulated industry.

We also found that the organizations, policies and procedures to identify potential conflicts of interest varied considerably. For example, DOE had issued regulations defining conflict of interest and was establishing formal procedures to identify conflicts. EPA had also issued regulations

defining conflict of interest. Both agencies rely on the individual contracting officers to identify and interpret potential conflicts. NHTSA, FCC, and CPSC have no regulations defining conflict of interest and rely exclusively on the contracting officers to interpret and identify conflicts. I would now like to present some of the details of our findings.

RESULTS OF THE ANALYSIS OF CONTRACT FILES

As requested, we identified contracts awarded to private companies to perform regulatory analyses. Executive Order 12044, "Improving Government Regulations," directs agencies to perform a regulatory analysis whenever a regulation may have major economic consequences for the general economy, for individual industries, geographical regions, or levels of government. Although each agency is to develop its own analysis criteria, it must assure an early and rigorous examination of all the alternatives for achieving the stated objective. The proposed regulation must be cost effective and impose a minimum economic burden on the private sector. The Executive order applies to the executive agencies. The independent regulatory commissions included in our inquiry were voluntarily complying with the Executive order.

Officials at the organizations we visited stated they often contract with private companies to perform all or part of a regulatory analysis. The issues, in most cases, are so complex that the organizations generally perform the analysis

by awarding several contracts, each of which provides data or background information for a portion of the overall analysis. We therefore included in our sample any contract that required some form of regulatory analysis, economic feasibility analysis, or cost-benefit study. Most of these contracts did not specifically identify a proposed regulation but supported an issue which affected several rules or regulations.

We found considerable variance in the information companies provided in their proposals. Some proposals contained very detailed presentations of the history and experience of the company and its principal investigators. Other proposals had very little information about the history and experience of the company.

As a general rule, most companies provided detailed experience of their studies or projects performed for various Government agencies but were vague when discussing their work with private industry. Typically, a company would describe its projects with private industry but would not identify the sponsor. A few companies stated they had extensive experience in an industry but did not specify the type of experience. Because of these variations and inconsistencies, we could not in all cases identify specifically what the principal investigators or the companies had done for the regulated industry.

We identified potential conflict-of-interest situations in 101 contracts. As stated earlier, this number may not represent the total contracts awarded by the agencies. In addition, since we did not identify the universe, we cannot draw any conclusions regarding the potential impact on the regulatory process. The results of our analysis are summarized below:

CONTRACTS AWARDED SINCE JANUARY 1977

<u>Organization</u>	<u>Number of contracts reviewed</u>	<u>Value of Contracts</u>	<u>Contracts with potential conflicts identified</u>	<u>Value of contracts</u>
EPA	71	\$64,442,013	51	# 50,072,847 \$51,158,466
NHTSA	41	8,743,963	21	5,459,090
DOE	27	18,085,689	21	13,537,139
FCC	7	858,511	4	420,998
FERC	6	4,556,444	0	-0-
CPSC <u>1/</u>	<u>4</u>	<u>3,180,583</u>	<u>4</u>	<u>3,180,583</u>
	<u>156</u>	<u>\$99,867,203</u>	<u>101</u>	<u>\$72,670,657</u>

1/Includes contracts awarded since 1975.

The following examples represent the different types of potential conflicts we identified:

--A DOE contractor received \$423,040 to provide quick-response technical evaluation and planning support in three specific program areas. Although the company asserted in the contract that no conflict of interest

existed, the proposal included a section on direct industry and institutional experience. This section described substantial work performed for private clients in the energy field.

--A contractor in an EPA study for \$1,558,995 on water pollution control has performed many studies for private companies and public utilities on various aspects of waste and water disposal. The principal investigators have also been responsible for designing and developing waste water facilities for several industries.

--NETSA issued three contracts totaling \$575,565 to perform studies on high-volume industrial processing rates and material substitution for the automobile industry. Most of the principal investigators have held responsible positions in companies in the automobile industry. In its proposal, the contractor claimed one of its strengths was the staff's extensive experience in the industry.

--A large certified public accounting firm contracted with FCC for \$117,000 to study the depreciation rate practices and policies of public utilities to determine if rule changes were warranted. The contractor claimed to have considerable experience in pricing

utility services and has assisted clients in preparing formal applications for rate increases.

Members of the staff have presented expert testimony in rate proceedings. The contractor stated in its proposal that this association would not affect its objectivity.

--EPA issued three contracts totaling \$880,635 for cost analysis of air pollution control systems. A subcontractor on one of the projects is a trade association of companies that manufacture and supply 88 percent of all industrial air pollution control equipment in the United States. Another EPA contract was issued for \$252,296 to perform a study of the best available technology for ore mining and effluent waste. The contractor has a wholly owned subsidiary to manufacture and market products emerging from its research.

THE PROCEDURES FOR IDENTIFYING
POTENTIAL CONFLICTS OF INTEREST

We believe that the Government should address the potential for both organizational and individual conflicts of interest during its contract review process. As defined in your request, an organizational conflict of interest is a situation where a prospective contractor has an interest in the product or industry being regulated, which could preclude it from providing a totally objective work product.

An individual conflict of interest may include situations where officers, project managers, deputy project managers, consultants, or any staff members have a personal interest in the product or industry being regulated, which could preclude them from rendering a totally objective work product. In addition, we believe an agency should consider the past interests of a contractor as well as any current and future interests that may affect the objectivity of a work product.

Each organization we visited addressed to varying degrees the potential for organizational conflict of interest. None, however, considered the potential for individual conflicts of interest during their contract review. Only DOE considered past associations as well as present and future associations when reviewing for conflicts of interest. The others considered only present and future associations.

A brief description of the procedures at each agency we visited should demonstrate the differences we found.

EPA

The regulations in EPA address only organizational conflicts of interest and require (1) a statement in each proposal that the offeror is free of any organizational conflict of interest and (2) a clause in each contract that the company will notify EPA of any conflict of interest that may develop during the life of the contract. EPA officials may,

at their discretion, exclude from consideration any manufacturer or seller of a substance that is being evaluated for potential regulatory action. In situations where a conflict of interest is identified, EPA's general counsel advises the program officials about the effect of the conflict in order to determine whether the company should continue to participate in the contract. As a general rule the interpretation and implementation of these requirements are the responsibility of each of the operating groups in EPA.

NHTSA

NHTSA officials told us that, although they are sensitive to the conflict-of-interest issue, they do not have any formal policies or procedures for identifying potential conflicts of interest. Instead, NHTSA depends on an informal process of relying on the alertness of its contracting personnel to identify and prevent any conflicts of interest. NHTSA officials claimed that such an informal system seems to have worked well and that detailed policy guidelines covering potential conflicts of interest would be difficult to administer and enforce.

DOE

DOE's regulations require that all proposals include an organizational conflict-of-interest disclosure describing all relevant facts concerning any past, present, or planned

interest relating to the work to be performed under the contract. In the absence of any relevant interests, the contractor must submit a certifying statement to such effect. The contracting officer has the responsibility, under the regulation, to determine whether a potential organizational conflict of interest exists. However, DOE officials stated that all contracts are being forwarded to the Office of General Counsel for a review for legal sufficiency of the organizational conflict-of-interest determination. A DOE order formalizing these procedures is currently being drafted. The potential for individual conflict of interest is not considered.

FERC

FERC is an independent regulatory commission within DOE. Because of their close association, FERC is following DOE's regulations on organizational conflict of interest.

FCC

FCC officials do not believe they have a problem with any company regarding conflicts of interest. Because of their small size and the relatively few contracts they award, they believe the contracting office can identify and resolve any conflict that may occur. In addition,

they include a clause in each contract that requires a company to certify that it has no present conflict of interest that would affect the objectivity of its work product.

CPSC

CPSC contracting officials told us they rely on the contractor to inform them of any conflicts of interest. Each contract CPSC awards requires the company to advise CPSC whenever an assigned task conflicts with or appears to conflict with its obligation regarding a subject of foreseeable regulatory action. The contract prohibits the company with the particular task in question to proceed until CPSC provides written approval.

In closing I would like to comment that this issue of potential conflicts of interest in consulting contracts is a part of a much broader issue--that being the proper use of consulting service. Recently, GAO has done work on this broader issue and just last month reported on the need for Federal agencies to tighten their controls over the use of consulting contracts. We also reported in July 1979 on the Department of Energy's policies and procedures for avoiding conflicts of interest in consulting contracts.

Mr. Chairman, this concludes my prepared statement. I would be happy to answer any questions you may have at this time.