

COVENANT AGAINST CONTINGENT FEES

Background: In many areas of commercial business, salespeople are expected to utilize their relationships and business contacts to generate or retain business and are compensated through commissions, success fees, or other measures tied to the level of business produced. For government contractors, however, offering such incentives to its internal or external sales force may create potential liability for the company.

Summary of Laws and Regulations: Contingent fees, defined as any payments conditioned upon the success an entity has in securing a government contract, are prohibited by law in negotiated contracts (41 U.S.C. § 254(a)) and by regulation in sealed bid procurements (FAR §§ 3.400 and 3.403). Contractors are required to warrant that no agent or employee has been engaged to obtain the contract for a contingent fee. (FAR § 52.203-5). This broad proscription, however, has a number of exceptions. The rule is inapplicable:

- To the acquisition of commercial items under FAR Part 12.
- To acquisitions below the simplified acquisition threshold (currently \$100,000 for most contracts within the U.S.).
- When the “entity” receiving the contingent fee is a bona fide employee. A “bona fide employee” means a person, employed by the contractor and subject to the contractor’s supervision and control as to time, place, and manner of performance, who neither exerts nor proposes to exert improper influence to solicit or obtain any government contract(s).
- When the “entity” receiving the contingent fee is a bona fide agency. A “bona fide agency” means an established commercial or selling agency, maintained by a contractor for the purpose of securing business, that neither exerts nor proposes to exert improper influence to solicit or obtain any government contract(s).

The exceptions to the general prohibition reflect the policy purpose behind the ban – to prevent the actual or attempted exercise of improper influence by third parties over the procurement system. The current FAR defines “improper influence” very broadly as “any influence that induces or tends to induce a Government employee or officer to give consideration or to act regarding a Government contract on any basis other than the merits of the matter.” FAR § 52.203-5(b).

Prior to 1996, the FAR contained more detail regarding contingent fees and a list of factors to consider when evaluating the permissibility of a contingent fee. While no longer present in the regulation, these factors are consistent with the underlying policy pertaining to contingent fee arrangements and may serve as useful guidance when contemplating a contingent fee arrangement with a consultant or other entity:

- The fee should not be inequitable or exorbitant, when compared to the services performed or to customary fees for similar services related to commercial business.
- The entity should have adequate knowledge of the contractor’s products and business, as well as other qualifications necessary to sell the products or services on their merits.
- The contractor and the entity should have a continuing relationship or, in newly established relationships, should contemplate future continuity.

- The bona fide agency should be an established entity that has existed for a considerable period, or, if it is a newly established going concern, it should be likely to continue in the future. The business of the agency should be conducted in the entity name and characterized by the customary indicia of the conduct of regular business.
- While an entity that confines its selling activities to government contracts is not disqualified, the fact that an agency represents the contractor in government and commercial sales should receive favorable consideration.

Consequences for Violations: Misrepresentations with respect to the contractor's warranty against contingent fees can result in the rejection of a bid or proposal, annulment of the contract without cost or liability to the government, or deduction of the full amount of any contingent fee from the contract price. Such misrepresentations may also lead to the initiation of suspension or debarment proceedings and referral to the Department of Justice for potential prosecution of a false statement in connection with the contractor's certification that it paid no contingent fees (FAR §§ 3.402 and 3.405). The imposition of penalties such as rejection of a bid or proposal and referral to the Department of Justice does not require the actual award of a contract to the contractor.

Practitioner Tips: This Update discusses only one of the many restrictions on the business practices of government contractors. Contractors that are considering any sort of contingent-fee arrangement with respect to government opportunities should:

- Avoid contingent fee arrangements when possible.
- Obtain legal review of the contract or other agreement which establishes such an arrangement, prior to entering into a contingent fee arrangement.
- Understand the actions a bona fide employee or agency may take with regard to obtaining a government contract, require periodic reports regarding such actions, and remain vigilant that such actions do not involve improper influence.

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