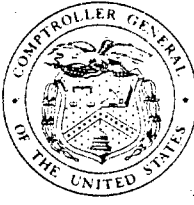


11524 PL-1



**DECISION**

**THE COMPTROLLER GENERAL  
OF THE UNITED STATES**  
WASHINGTON, D. C. 20548

FILE: B-194201

DATE: September 26, 1979

MATTER OF: Metro Electric, Inc. *DLG02873*

*[Protest of GSA Contract Award]*

DIGEST:

1. Federal Procurement Regulations (FPR) prohibit Government from contracting with corporations substantially owned or controlled by its employees. While Government employee shareholders of protester may have relinquished all corporate control by placing their stock in trust, Government employees have retained equitable ownership in protester so that procuring agency is justified in analyzing amount of their stockholdings to determine if they constitute substantial ownership for purposes of FPR.
  
2. Because issue of control is separate from issue of ownership for purpose of applying FPR, GAO questions propriety of procuring agency's determination of substantial ownership by comparing percent of stock owned by Government employees with percent of stock owned by other individuals in protester. GAO believes that determination of substantial ownership for purposes of FPR should be made solely on basis of relationship of amount of Government employee stock to total amount of stock in protester. Nevertheless, if GSA intends different meaning of substantial ownership, GAO suggests amending FPR to clarify any such meaning.

Metro Electric, Inc. (Metro), protests the award of a contract to another bidder under solicitation No. ROC 88071 issued by the General Services Administration, Public Buildings Service (GSA). The solicitation was for the electrical renovation of steam tunnels in the Washington, D. C., steam distribution complex.

*DLG02873*

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GSA determined that no contract could be awarded to Metro because of Federal Procurement Regulations (FPR) § 1-1.302-3 (1964 ed. amend. 95). This section of the FPR provides as follows:

"Contracts between the Government and Government employees or business concerns substantially owned or controlled by Government employees.

"(a) Contracts shall not knowingly be entered into between the Government and employees of the Government or business concerns or organizations which are substantially owned or controlled by Government employees, except for the most compelling reasons, such as cases where the needs of the Government cannot reasonably be otherwise supplied."

Metro has two Government employees, James L. Martin, Jr., and Leo Glascoe, who have 23-1/2 percent of that company's stock between them. Both had placed their stock in trust prior to the issuance of the protested solicitation. Despite the trusts, however, GSA found that Metro was substantially owned by these two Government employees.

Metro states that it bid on the solicitation as the prime electrical contractor and was the lowest bidder. Metro also states that its problems with GSA on the matter of ownership began with a prior GSA solicitation for fire alarm systems. At the time of that solicitation, Metro had three directors and stockholders owning 38.99 percent of the company who were employed by the Government. According to Metro, after it had submitted a bid, GSA informed it that there was a possible conflict of interest. Consequently, Metro wrote a letter on May 4, 1978, to GSA concerning its stockholders. By letter dated May 26, 1978, GSA responded by stating that the point at which a company is not substantially owned by Government employees would be somewhat less than 25 percent.

Metro contends that two of the three Government employee stockholders subsequently divested themselves of ownership by placing their stock in trust. Under the trust of James L. Martin, Jr., the income from the trust is paid to his two children. The trustees are Mr. Martin's parents. The terms of the trust also provide that the trust will terminate in the event of the death of both children or 30 days after Mr. Martin ceases to work for the Government with the trust principal then being distributed to Mr. Martin. The terms of Leo Glascoe's trust are similar except that the income from the trust is to be paid to Mr. Glascoe's father-in-law and mother-in-law. Like Mr. Martin's trust, Mr. Glascoe's trust will terminate upon the death of both trust beneficiaries or 30 days after Mr. Glascoe ceases to work for the Government.

In addition, Metro states that prior to its bidding on the protested solicitation, it held a stockholders meeting where new officers were elected. Thus, Metro avers that two of the three Government employee stockholders now no longer hold office in the company. As to the third Government employee stockholder, Metro indicates that this individual has since retired from the Government.

With regard to whether Mr. Martin's and Mr. Glascoe's Government employment conflicts with their association with Metro, Metro has submitted with its protest two letters from their supervisors to the Small Business Administration. The first letter dated June 14, 1979, is from the Sergeant at Arms, United States House of Representatives, which declares that Leo Glascoe's interest in Metro would in no way present any conflict with his duties in the Office of the Sergeant at Arms. The second letter, undated, is apparently from Mr. James L. Martin's Supervisor at "DEA" stating that it is reasonable to assume that Mr. Martin's function with DEA would not allow him any advantages in assisting Metro in any possible means of obtaining that company's goals. ACC00002

GSA takes the position that the purpose of FPR § 1-1.302-3 is to avoid any appearance of favoritism or preferential treatment by the Government toward its employees. See 41 Comp. Gen. 569 (1962). The only factors under this provision of the FPR are substantial

ownership or control of a company by a Government employee. Consequently, GSA believes that the duties of the Government employee and the particular agency for which he works are not considerations.

GSA points out that FPR § 1-1.302-3 does not define substantial ownership or control. However, GSA refers to our decision in Capital Aero, Inc., B-183833, September 30, 1975, 75-2 CPD 201, in which we noted that the regulation does not speak of "majority" ownership, only "substantial" ownership. In that case we concluded that in light of the significant history which has discouraged contracting between the Government and its employees, a Government employee owning 39.95 percent of the stock in a corporation had substantial ownership in that corporation.

Nevertheless, GSA recognizes that we did not determine in Capital Aero, supra, whether the holding of a small amount of stock by Government employees is sufficient to bring the company within the general rule that it is undesirable for the Government to contract with its employees. Mr. Martin and Mr. Glascoe each own 11.76 percent of Metro's stock and thus cumulatively own 23.52 percent. GSA states that there are 16 stockholders in Metro, six of whom own 9 percent or more of the total stock. The largest single holding is 23.53 percent. Based on the relationship of the block of stock owned by these two Government employees to the percent of stock owned by the other Metro shareholders, GSA decided that 23.52 percent did constitute substantial ownership in the company. While GSA admits it had initially indicated to Metro that somewhat less than 25 percent would not be considered substantial ownership, it states that the final determination that Metro was still substantially owned by Government employees was made because of the relationship of their 23.52 percent of stock ownership to the other stockholdings in the company.

GSA also contends that the trusts of Mr. Martin and Mr. Glascoe have to be analyzed from the point of view whether an appearance of impropriety still exists even though legal title to the stock no longer rests with these individuals. GSA asserts that Mr. Martin and Mr. Glascoe are, in effect, beneficiaries under their respective trusts and both have vested reverter

interests in the trust corpus. While it is true that they will not receive any income from the stock during the period of their Government employment, GSA argues that they will enjoy the affected value of the stock later. Therefore, GSA believes even though Mr. Martin and Mr. Glascoe do not now have full legal title to the stock, the effect of their interest in the stock as far as the appearance of impropriety is concerned is the same as when their ownership of the stock was full.

With regard to whether Metro is controlled by Government employees, GSA contends that it is unnecessary to show control in addition to substantial ownership since the regulation is phrased in the alternative. In any event, by placing the authority to vote their stock in the trustees under the terms of their trusts, GSA believes Mr. Martin and Mr. Glascoe have divested themselves of any control over Metro during the period of their Government employment.

In rebuttal, Metro claims that GSA has interpreted FPR § 1-1.302-3 beyond the scope of any previous decision by this Office. Metro characterizes our decision in Capital Aero, Inc., supra, as involving a situation where one Government employee owned 39.95 percent of a company's stock. In Metro's opinion, GSA has interpreted the word "substantial" as being a far lower percent of ownership than 39.95 percent that we found in that decision. Further, Metro points out that GSA recognizes that Mr. Martin and Mr. Glascoe will not receive income on the stock placed in trust. According to Metro, the fact that these individuals will enjoy the affected value of the stock after their Government employment ceases is true for any Government employee who places his corporate stock in trust, including the President of the United States. Thus, Metro requests that the determinations made by GSA be rejected by us because they have no basis in law of fact.

Finally, Metro alleges that it has in the past entered into contracts with other governmental agencies. In support of this allegation, Metro has furnished us with copies of contracts entered into with the United States Soldiers' and Airmen's Home and Howard University. By entering into contracts with it, Metro believes that

this implies that these agencies determined that there was no conflict of interest.

#### GAO ANALYSIS

We have stated that while contracts between the Government and its employees are not expressly prohibited by statute, they are undesirable and should be authorized only where the needs of the Government cannot be reasonably supplied otherwise. 55 Comp. Gen. 681 (1976), and the cases cited therein. Such contracts are open to criticism as to alleged favoritism and possible fraud. 41 Comp. Gen. 569 (1962). FPR § 1-1.302-3, then, is the regulatory implementation of well-established policy.

The prohibition against the Government entering into contracts with its employees is equally applicable to corporations owned by Government employees. Capital Aero, Inc., supra. Here, however, Metro takes the position that by placing their stock in trust, Metro's two Government employee shareholders have divested themselves of the ownership of such stock.

We believe that Metro has confused ownership of the stock with control over it. We agree with GSA that by placing the authority to vote their stock in the trustees, Mr. Martin and Mr. Glascoe have divested themselves of any control over the stock while they are employed by the Government. Also, as Metro points out, it is common practice for high-ranking Government officials to establish a temporary trust for their own benefit, usually lasting for the duration of their tenure in Federal office. S. Report No. 95-639, 85th Cong., 2nd Sess. (1978). These trusts, which are termed "blind trusts," serve important objectives. They relieve Government officials from day-to-day investment decisions on the trust assets, which decisions may conflict or interfere with Government duties. Further, they play an important role in reducing the appearance of a conflict of interest.

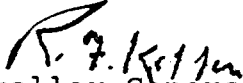
The placing of assets in a blind trust does not, however, mean that the Government employee trustor has divested himself of full ownership of the trust assets. Indeed, one of the primary reasons for the use of the blind trust is that actual divestiture of ownership of

the Government employee's assets may result in burdensome tax consequences. S. Report No. 95-639, supra. Moreover, the fact that the trusts of Mr. Martin and Mr. Glascoe will terminate automatically 30 days after they cease to be employees of the Government, in our opinion, is in itself sufficient to show that there has not been a complete divestment of ownership of their trust assets (Metro's stock).

Moreover, we believe that the role of the Government employees in the management and control of the corporation is for purposes of the applicability of FPR § 1-1.302-3 a separate consideration from whether the Government employees substantially own that corporation. The rationale of the rule prohibiting the Government from contracting with its own employees is not merely to avoid any conflict of interest that might arise between the employees' interests and their Government duties. It is also to avoid possible criticism of favoritism or preferential treatment by the Government toward its employees. In this regard, if the Government employees have retained a substantial equitable ownership in the corporation, we think that this is enough in itself to invoke the above-described rule.

On the other hand, because the issue of control is separate from the issue of ownership for purposes of applying the regulation, we question the propriety of GSA's determination of substantial ownership by comparing the percent of stock owned by Mr. Glascoe and Mr. Martin to the percent of stock owned by each of the other stockholders. In Capital Aero, Inc., supra, we noted that the regulation does not speak of "majority" ownership, only "substantial" ownership. Nevertheless, we found in that case that the amount of stock owned by the Government employee was so significant in relation to the total amount of the corporation's stock as to constitute substantial ownership. While a comparison of the amount of stock owned by Government employees with the amount of the corporate stock owned by other individuals may be relevant to a determination of whether the Government employees have substantial control in the corporation, we do not believe such comparison is relevant to the determination of whether the corporation is substantially owned by the Government employees.

We believe that the determination of substantial ownership for purposes of FPR § 1-1.302-3 should be made solely on the basis of the relationship of the amount of Government employee stock to the total amount of the corporation's stock. Accordingly, Metro's protest is sustained. However, no purpose would be served by referring the matter back to GSA for a determination on this basis since the completion date for the contract repair work was August 28, 1979. If GSA intends a meaning of the term "substantial ownership" different from ours and if it anticipates that there will be a significant number of situations in the future involving the application of FPR § 1-1.302-3, we suggest amending the regulation to clarify any such meaning of this term.

  
Deputy Comptroller General  
of the United States