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The New Rules Governing Real Property Leasing by GSA

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Introduction

On May 27, 2011, the General Services Administration ("GSA") published a final rule substantially revising its regulations for acquiring leasehold interests in real property, which is Part 570 of the GSA's Acquisition Regulation ("GSAR"). *See* 76 Fed. Reg. 30,842 (May 27, 2011). The GSAR rewrite of the leasing regulations, which became effective on June 27, 2011, adopts some long-established leasing policies into formal regulation and requires that certain clauses must now be inserted into the body of GSA leases.

The Federal Acquisition Regulation Generally Does Not Apply To GSA Leasing

For many years, GSA has taken the position that the Federal Acquisition Regulation ("FAR") does not apply to lease acquisitions unless GSA specifically incorporates a FAR clause into GSAR part 570. In the new rules, GSA has explicitly adopted this policy and explains the basis for it: "The FAR does not apply to leasehold acquisitions of real property. Where referenced in this part, FAR provisions have been adopted based on a statutory requirement applicable to such lease acquisitions or as a matter of policy . . . ." 76 Fed. Reg. at 30,848 (to be codified at 48 C.F.R. § 570.101(d)). And, not surprisingly, the new rules incorporate some new statutory and policy requirements from the FAR – discussed in detail below.

No More Sealed Bidding

The new rules eliminate the option of soliciting leases through sealed bidding – thus ending a process GSA has rarely, if ever, used in the past several years. 76 Fed. Reg. at 30,843. GSA states that it will only use negotiated procurements because "negotiations or discussions are not allowed under sealed bidding" and the ability to negotiate "enables GSA to clarify and explain SFO requirements to more effectively address the unique elements of each property and obtain better lease pricing." *Id.* The standard form Solicitation for Offers ("SFO") that GSA has used for at least the last five years presumes that there will be negotiations, including immediately after award, but before execution of the agreement. SFO §§ 1.12, 2.9.

ABOA Standard

The new rules codify GSA's efforts to eliminate the use of the term "usable square feet" in favor of the American National Standards Institute/Building Owners and Managers Association Office Area ("ABOA") standard. 76 Fed. Reg. at 30,848 (to be codified at 48 C.F.R. §§ 570.102, 552.270-4(a), and throughout GSAR Part 570). As noted in its April 2011 Lease Reform Implementation Report, GSA wants to use one term – ABOA – to avoid any confusion. Previously, GSA has attempted to use both the "usable square feet" and "ABOA" terms interchangeably, but many offerors were confused by the different terms. Having one term should relieve some of this confusion.

Novation & Change of Name

Buyers and sellers of buildings that lease space to GSA have regularly been asked to novate their leases with GSA assuring that a smooth transition of claims,

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rights, and obligations transfer – *i.e.* the buyer, seller, and GSA enter a novation agreement. The GSA's new rules codify this long understood requirement and specifically state that FAR Part 42.12 (48 C.F.R. § 42.12) governs when a novation is necessary. 76 Fed. Reg. at 30,850 (to be codified at 48 C.F.R. § 570.115). The Government requires such a novation agreement to avoid the general prohibition on transferring Government contracts and claims under the Assignment of Contracts Act, 41 U.S.C. § 6305, and the Assignment of Claims Act, 31 U.S.C. § 3727. Notably, the FAR's novation rules specifically exempt from this requirement any changes in ownership as a result of a stock purchase where there is no legal change to the entity contracting with the Government. 48 C.F.R. § 42.1204 (b). The FAR's rules also include a standard novation agreement that agencies (including GSA) often use with very few changes. *See id.* § 42.1204(i).

Sustainability & Green Initiatives

The new rules incorporate sustainability and green initiatives including, among other things, codifying that GSA will "accomplish the requirements" imposed by Executive Order 13514 – Federal Leadership in Environmental, Energy, and Economic Performance – for lease acquisition. 76 Fed. Reg. at 30,850 (to be codified at 48 C.F.R. § 570.117-1). (Executive Order 13514 builds on the earlier Executive Order 13423 – Strengthening Federal Environmental, Energy, and Transportation Management.) Executive Order 13514 generally requires that 15% of the Government's lease acquisitions over 5,000 gross square feet meet the Guiding Principles of Federal Leadership in High Performance and Sustainable Buildings by 2015. The Guiding Principles seek to optimize energy efficiency, protect and conserve water, enhance indoor environmental quality through better ventilation and use of daylight, and use of increased recycling through the life-cycle of construction and operation of a building. 76 Fed. Reg. at 30,850 (to be codified at 48 C.F.R. § 570.117-2). GSA began incorporating some green and sustainable requirements in the standard SFO several years ago per Realty Service Letter 2007-12, including clauses throughout the standard SFO such as those requiring lessors to meet Leadership in Energy and Environmental Design ("LEED") certification for commercial interiors and new construction. Also, the standard SFO now incorporates requirements for Energy Star labeling per Realty Service Letter 2010-2, which have also been incorporated in the standard SFO.

Clauses Governing Procurement Integrity Act Requirements and Contingent Fee Prohibition Newly Moved to Leasing-Specific Regulations

GSA has moved several clauses specifically to the leasing regulations including two of particular note: (1) a clause to enforce the requirements of the Procurement Integrity Act; and (2) a clause to elucidate the scope of the Covenant Against Contingent Fees. 76 Fed. Reg. at 30,844; 74 Fed. Reg. 63,704, 63,705 (Dec. 4, 2009) (proposed rule). Although both clauses have been part of GSA's general procurement regulations for many years, moving them to the leasing-specific regulations reinforces their importance and specificity in lease acquisitions.

Price Adjustment for Illegal or Improper Activity: Under the "Price Adjustment for Illegal or Improper Activity" clause, if the head of the contracting activity or his designee determines there was a violation of the Procurement Integrity Act, GSA, at its election, may reduce the monthly rental by five percent for each month of the remaining term of the lease, and recover five percent of the rental already paid. 76 Fed. Reg. at 30,847 (to be re-codified at 48 C.F.R. § 552.720-30). In addition, if the violation extends to the Lessor's subcontractor, GSA can reduce payments due the subcontractor "by an amount not to exceed the amount of profit or fee reflected in the subcontract." These remedies are not exclusive and are in addition to any other remedies provided in the Procurement Integrity Act or the lease.

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Covenant Against Contingent Fees: Regarding the Covenant Against Contingent Fees, the moved GSAR clause continues to clarify what constitutes a "bona fide agency" whose services can be compensated on a contingent fee basis in the leasing context. 74 Fed. Reg. at 30,848 (to be re-codified at 48 C.F.R. § 552.270-32). According to this clause, a "bona fide agency" specifically includes "an established commercial or selling agency (including licensed real estate agents or brokers)." However, while such brokers may be compensated on a contingent fee basis, they may not "exert improper influence to solicit or obtain Government contracts."

New FAR Clauses that Apply

The new rules now incorporate various FAR clauses that were not previously incorporated into GSA leases. Some of the clauses will not raise any concerns from lessors, but others impose new obligations on lessors that are not typically found in private commercial leases.

Three FAR clauses warrant particular attention:

Contractor Code of Business Ethics and Conduct (48 C.F.R. § 52.203-13): GSA will insert this clause in all lease acquisitions expected to exceed $5 million with a performance period of more than 120 days. 76 Fed. Reg. at 30,854. This FAR clause imposes a host of new requirements on lessors, some of which may require significant changes in how a lessor conducts its business operations. In particular, this clause requires that a lessor provide a written code of business ethics to all personnel working on the government contract, set up an on-going business ethics awareness and compliance program, and set up an internal control system for ferreting out "credible evidence" that the lessor (or its principal employee, agent, or subcontractor) has committed a "violation of Federal criminal law involving fraud, conflict of interest, bribery, or gratuity violations found in Title 18 U.S.C. or a violation of the civil False Claims Act . . . ." *Id.* § 52.203-13. This FAR clause requires that a lessor's internal control system include seven "minimum" requirements:

(1) Assign responsibility for overseeing this program at a "sufficiently high level" of the company with adequate resources to ensure the ethics and conduct program is carried out;

(2) Make "reasonable efforts" to assure the principals overseeing the program have not previously engaged in unethical conduct;

(3) Conduct periodic reviews to monitor, evaluate, and assess the company's ethical practices, procedures, policies, and controls;

(4) Create a hotline or similar internal reporting method to allow anonymous or confidential reporting of any violation;

(5) Take disciplinary action for improper conduct or failure to try to prevent or detect improper conduct;

(6) Timely disclose to the contracting agency's Office of Inspector General and Contracting Officer any "credible evidence" of a violation of any of the listed federal criminal laws or the civil False Claims Act; and

(7) Provide "full cooperation" to Government agencies, including responding to document requests and making witnesses available for interviews.

Among other penalties, the Government may suspend and debar a lessor for a "knowing failure" to disclose "credible evidence" of a violation of the federal criminal statutes listed in the clause or the civil False Claims Act up to three years after final payment to the lessor.

Reporting Executive Compensation and First-Tier Subcontract Awards (48 C.F.R. § 52.204-10): This FAR clause requires that a lessor report all first-tier subcontract awards valued at more than $25,000 to a federal database with subcontractor information – www.fsrs.gov (the Federal Funding Accountability and Transparency Act Subaward Reporting System). 48 C.F.R. § 52.204-10(c)(1). This clause also requires that a lessor report the total compensation of each of

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the five most highly compensated executives of the lessor and its first-tier subcontractors for the preceding completed fiscal year if the lessor (or first-tier subcontractor) receives $25 million in annual gross revenues or 80 percent of its annual gross revenues from federal government contracts, subcontracts, loans, grants, subgrants, or cooperative agreements. *Id.* § 52.204-10(c)(2) & (c)(3). Publicly traded and other companies that already must periodically provide reports of executive compensation to the Securities and Exchange Commission (or per the Internal Revenue Code) are exempted because they already report this information to the federal government. GSA states that it will insert this clause in all acquisitions valued at more than $25,000. 76 Fed. Reg. at 30,853.

Display of Hotline Poster(s) (48 C.F.R. § 52.203-14): The new rules also require the display of a fraud hotline poster, but only if such a poster is not somehow already part of the internal controls maintained to root out fraud through a business ethics and conduct program. GSA will also insert this clause in all acquisitions expected to exceed $5 million with a performance period of more than 120 days.

Other FAR requirements newly applicable to GSA leasing appear less daunting. For example, the new rules impose a requirement that a lessor provide its Data Universal Numbering System (DUNS) number and assure that it registers in and for electronic funds transfers using the federal government's Central Contractor Registration system. 76 Fed. Reg. at 30,853 (to be codified at 48 C.F.R. § 570.701) (requiring that leases valued above the micro-purchase threshold incorporate 48 C.F.R. §§ 52.204-6, 52.204-7, & 52.232-33). These various requirements will apply to virtually all leases because they are triggered by a very low threshold (called the "micro-purchase" threshold), which generally means any acquisition above $3,000.

Additionally, lessors will now have to make new representations and certifications regarding whether they are women-owned businesses, update their small business status throughout the term of any signed long-term lease, and implement a policy of affirmative action and non-discrimination regarding employees or applicants with disabilities. *See* 76 Fed. Reg. at 30,853 (requiring leases to incorporate "Women-Owned Business (Other than Small Business)," 48 C.F.R. § 52.204-5, for leases expected to exceed the simplified lease acquisition threshold, "Post-Award Small Business Program Representation," 48 C.F.R. § 52.219-28, for leases exceeding the micro-purchase threshold, and "Affirmative Action for Workers with Disabilities," 48 C.F.R. § 52.222-36 for leases estimated to exceed $10,000).

Contracting for Overtime Services and Utilities in Leases

The new rules include new authority to allow a contracting officer to negotiate building service overtime rates with the lessor and to allow a warranted contracting officer's representative in GSA or the tenant agency to order overtime services and utilities for leased space. *See* 76 Fed. Reg. at 30,853 (to be codified at 48 C.F.R. § 570.601).

Conclusion

Any entity leasing real property to GSA needs to become familiar with GSA's new regulations governing such leasing activities. In particular, lessors with high-dollar-value leases need to ensure they are in compliance with the new Code of Business Ethics and Conduct requirements.

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