



OFFICE OF THE
City Auditor

Tender Conflict of Interest Investigation

May 20, 2009

The Office of the City Auditor conducted
this project in accordance with the
*International Standards for the
Professional Practice of Internal Auditing*

Tender Conflict of Interest Investigation

1. Introduction

In February 2009, the Office of the City Auditor was alerted to a potential conflict of interest involving a project contract with the Consultant that had recently hired an ex-employee of the City. Following a review of pertinent documentation, the City Auditor chose to initiate a comprehensive investigation into the matter.

2. Objective

Our objective was to determine whether or not the ex-employee was in a conflict of interest position with regard to the Consultant and/or the City's contracts with the Consultant.

3. Scope and Methodology

We began by extracting data from the City's financial system to identify all contracts awarded to the Consultant in question. We then reviewed the applicable contracting files maintained by Materials Management to determine whether there was sufficient evidence to justify a broader review. Based on the results of that review, we decided to review Departmental records related to specific contracts as well as Council, and Committee reports. We also reviewed the ex-employee's personnel records to identify significant dates (resignation date, last day of work, and last day on the City's payroll).

From the information we collected from these sources, we constructed an event chronology for the subject files. We also completed a detailed analysis of the purchasing documents in each of the Consultant's contract files.

We reviewed the City's Code of Conduct and the applicable Code of Ethics for the ex-employee's professional association. We then conducted research to identify current practices in the area of post-employment career restrictions, including a survey of local government organizations across North America. Based on those observations, we discussed the issue of post-employment restrictions with the Law Branch and Materials Management to better understand the issues.

4. Observations and Analysis

4.1. What did we find?

4.1.1. Post-employment restrictions

The City's Code of Conduct and the professional association's Code of Ethics do not limit an ex-employee's right to accept employment with an employer who then assigns the ex-employee to work on City projects in which his or her prior experience is pertinent.

There are several jurisdictions in the United States that have legislation prohibiting individuals from accepting post-employment positions in which they would continue to work for the same organization or part of the organization that formerly employed them. There are a few instances of local governments in Canada that have some form of post-employment restrictions. It is common for Canadian Federal and Provincial jurisdictions to restrict future employment of Ministers and senior bureaucrats.

In the instance we investigated, the ex-employee is currently employed by a Consultant that continues to provide services that the ex-employee participated in or oversaw as a City employee. To some degree, the City benefits from this arrangement since the ex-employee's expertise and knowledge continues to benefit City projects. However, there could be a perception that the ex-employee could have unfairly influenced contract awards prior to resigning from the City. We did not find any evidence that such influence actually occurred.

4.1.2. File review

We reviewed the files that Materials Management and the operating Departments maintain related to City contracts with the Consultant. Of the eight files we reviewed, we found that the ex-employee was involved in evaluating statements of qualifications (the step before inviting companies to submit proposals) for one contract in 2007, where the ex-employee assigned a four-point spread for the top four consultants with the Consultant rated highest. The evaluation team rated a different consultant highest in that exercise, but all four were invited to submit proposals. In the other files, there was no evidence that the ex-employee participated in proposal evaluations.

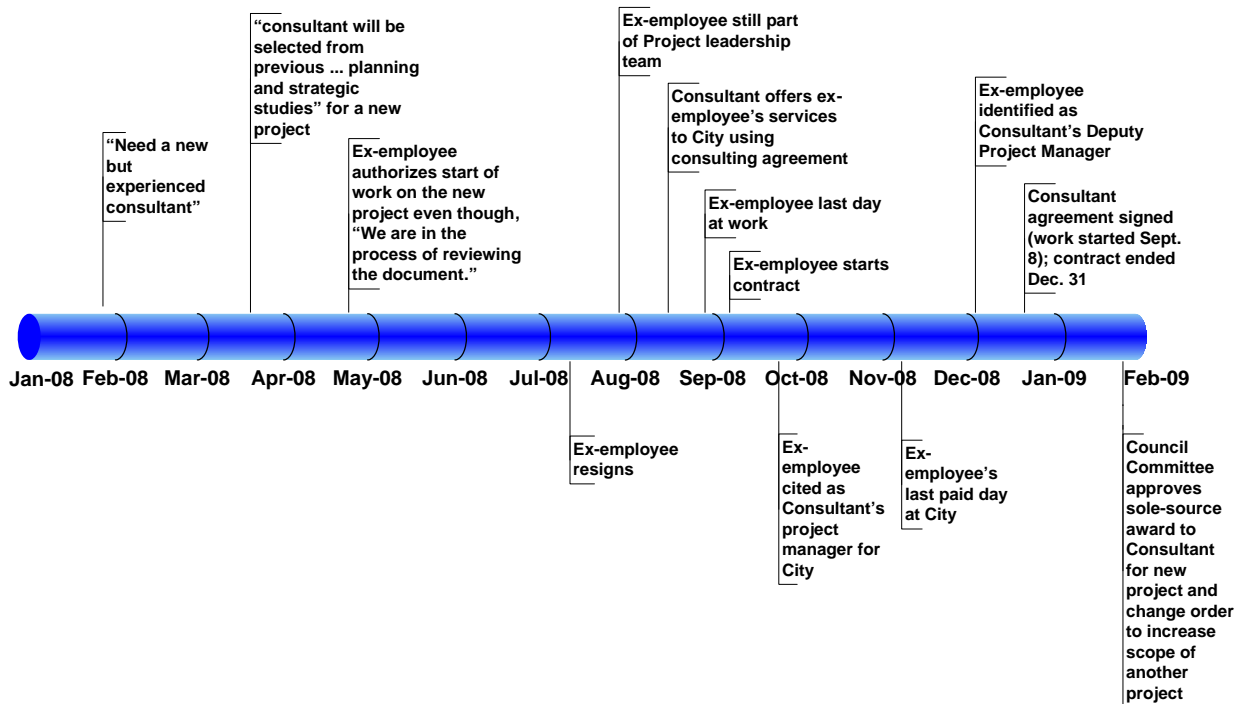
During the time in question, the City was embarking on a series of capital project plans that required specific expertise. In January 2008, the ex-employee indicated in a planning document that "a new but experienced consultant" was needed because "existing capable consultants are already doing work for the Department." In March 2008, the ex-employee wrote a report to a Council Committee stating, "To expedite the process, a consultant will be selected from proposals from previous [project] planning and strategic studies." In April 2008, the ex-employee sent an email to the Consultant authorizing start of work on this new project even though, "We are in the process of reviewing the document" (the 'document' was the Consultant's proposal to undertake the new project). Between April and July 2008, the files have documents (emails,

reports, etc.) indicating that the ex-employee was involved in ongoing projects at a level consistent with the ex-employee’s position.

4.1.3. Timeline

On July 11, 2008, the ex-employee submitted a resignation letter specifying August 29, 2008 as the last day of work. In a July 23, 2008 workshop summary in which the Consultant and the City are participants, the ex-employee is identified as a part of the City’s project leadership team. An August 14, 2008 letter from the Consultant offered the ex-employee’s services to the City as a program advisor, working on projects in which the ex-employee was involved in as a City employee. The ex-employee began work on that contract on September 8, 2008 even though the purchase order for those services was not completed until December 15, 2008 (the contract expired on December 31, 2008). On December 1, 2008, the Consultant identified the ex-employee as the Deputy Project Manager for a consolidated program plan that the City awarded to the Consultant in stages during 2008 and early 2009. Figure 1 shows the timeline of significant events.

Figure 1: Potential Conflict of Interest Timeline



While there was no evidence in the City’s files that the ex-employee violated the City’s Code of Conduct or the professional association’s Code of Ethics, the sequence of events illustrated in Figure 1 could lead to a perceived conflict of interest. While not evidence of wrong-doing, the sequence of events in the timeline does not include any sort of “cooling-off period” between the ex-employee’s City employment and conducting work for the City as the Consultant’s employee. In fact, the Consultant offered the ex-employee’s services to the City while the ex-employee was still employed by the City.

Another issue is the risk that the City could be perceived as directing work to specific consultants because those consultants have ex-City employees included on project teams. We did not find any evidence that this was the case in this instance.

In the consulting industry, the strength of the project team will always be a part of bid or proposal evaluations. For work that has to be contracted (e.g., much of the City's streets infrastructure work), it is in the City's best interests to contract with the teams that provide the best value. In at least some instances, those teams are likely to include people who either retired from or left City employment as recognized experts in their fields.

4.1.4. Literature review

It has not been uncommon for City employees to retire and go to work for consulting companies which then sell the ex-employees' services back to the City. The practice is not specifically prohibited by either the City's Code of Conduct or the City's standard contracting agreements. In addition, there are no post-employment restrictions in the City's standard employment contracts.

One method used by increasing numbers of employers is to incorporate "restrictive covenants" into employment contracts that restrict an employee's post-employment activities. An article posted on the Canadian Bar Association's website states:

Where the employer attempts to enforce a restrictive covenant, the threshold issue confronting the court will be whether the covenant is "reasonable." The leading Canadian case on point is *Elsley v. J.G. Collins Insurance Agencies Ltd.* [1978] 2 S.C.R. 916, where the court established a three-fold test for determining the enforceability of restrictive covenants:

1. The employer has a legitimate proprietary interest that it is entitled to protect;
2. The restraint is reasonable between the parties in terms of temporal length, geographical area, the nature of the activities prohibited and overall fairness; and
3. The restraint is reasonable with reference to the public interest.

...the court will presume that the covenant is *prima facie* void as being in restraint of trade and is contrary to public policy unless that presumption is rebutted by the party seeking to enforce the covenant showing that it was both necessary and reasonable in all of its circumstances.

... A clause that is over-reaching or which goes beyond the absolute minimum level of protection that is required to protect the otherwise business interest will not be enforced.¹

¹ <http://www.cba.org/Abc/nouvelles/pdf/ADD-enforceability.pdf> (Canadian Bar Association)

A Canadian law firm that has published an article on restrictive employment covenants states:

...trial judges are increasingly concerned with issues of fairness and conscionability. Courts have expressly recognized that the contract of employment has many characteristics that set it apart from an ordinary commercial contract, among them the lack of free bargaining power.²

Restrictive covenants that are designed to protect confidential or insider information or to protect intellectual property seem to be more defensible than those that focus on competitive actions.

4.1.5. Tendering considerations

The issue presented to us in this instance involved the City awarding a series of contracts to a Contractor that hired the ex-employee. The timing of the events shown in Figure 1 could create the appearance of bias in the tendering process. While we did not find any evidence that bias existed, even the perception of bias could create unwanted levels of risk for the City.

4.2. What can the City of Edmonton do?

In our opinion, the likelihood that employees will continue to retire or resign and start working for companies that regularly provide services to the City is high. In order to lessen the potential for apparent or real conflicts of interest, we believe that employees need to notify their supervisors when they accept an employment offer. This is especially important if the employee currently has a business relationship with the new employer. At that point, we believe that the employee should not be involved in any decisions or processes involving that potential employer (Recommendation 1).

One post-employment restriction technique that we observed in a Canadian municipality was to limit the ability of contractors or consultants to use certain ex-employees (those who left under retiree incentive or under voluntary or position termination conditions) on projects for the employer. These restrictions were time-limited and limited to a very select group of employees, as were most of the post-employment restriction clauses we researched. In the case of Ministers or senior bureaucrats at the Federal or Provincial level, restrictions generally have durations of up to one or two years. Some of the restrictive clauses we researched specified post-employment restriction durations of as little as six months. Since the City is subject to the provisions of the interprovincial Agreement on Internal Trade (AIT) and the Alberta/British Columbia Trade, Investment and Labour Mobility Agreement (TILMA), any potential post-employment restrictions must comply with the requirements of those agreements.

² http://www.blakes.com/english/view_printer_bulletin.asp?ID=235 (Blake, Cassels & Graydon LLP)

4.2.1. Resolution of Audit Issues

During our audit, we asked the Law Branch to provide input on the legal measures that are available to the City to restrict an ex-employee's post-employment activities and/or to add restrictive clauses to the City's tender documents.

Law Branch indicated that options for limiting an employee's post-employment activities are limited. Employees who make policies and decisions for the corporation (fiduciary employees) are subject to an overall duty of loyalty to their employer which continues beyond the term of their employment. It prevents them from adversely affecting their former employer's interests by using knowledge they acquired in the course of their former employment, such as stealing a ripening business opportunity from the former employer. However, very few employees would be considered fiduciaries (e.g., members of the City's Senior Management Team). Ordinary employees are not prevented from competing with a former employer, or from selling their services to a former employer. In the case of this investigation, the ex-employee was not in a fiduciary role, and his new consulting activities may actually benefit, not harm, the City's interests.

Law Branch also advised that courts would not enforce restrictive covenants restricting post employment activities if those restrictions are imposed on existing employees who accepted offers of employment without such conditions. The City could incorporate appropriately limited restrictive covenants into future senior executive employment contracts in order to protect its legitimate proprietary rights.

The Employee Code of Conduct is incorporated into all City employment contracts. Expanding and clarifying particular sections of the Code (e.g., Personal Gain or Benefit, Disclosure of Information, Personal Conduct) and its accompanying guidelines could provide clearer standards and direction to employees about what is acceptable conduct when leaving the City's employ. However, Code changes could not be used to alter existing employment contracts to prevent employees from taking other employment, even if the employee's expertise was largely acquired as a City employee.

Law Branch also indicated that since the City is generally obligated to use open and competitive tendering processes for procuring goods and services, it is not advisable to change tender documents to restrict former employees (or companies that employ former employees who would work on a project) from submitting bids on City projects.

5. Conclusion and Recommendation

We found no evidence that the ex-employee or the Consultant breached any legislation or applicable codes of conduct. We did determine, however, that there may be opportunities for the City to strengthen its employment and contracting standards to reduce the risk of both real and perceived conflicts of interest. Such conflicts or apparent conflicts can arise when an employee with decision-making authority or procurement influence resigns and goes to work for a company that provides services to the City that encompass the ex-employee's area of responsibility.

We believe that the following recommendation will help the City limit the impact of similar situations in the future.

| Recommendation 1 | Management Response and Action Plan |
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| <p>The OCA recommends that the City Manager implement procedures that require employees who have accepted employment outside of the City to remove themselves from all processes and projects in which their new employer is involved.</p> | <p>Response: Accepted</p> <p>Action Plan: We will develop procedures to ensure that City employees who accept employment with another employer do not continue to work on projects that involve their future employer. This may be in the form of further instruction in the Employee Code of Conduct, modification of the City's standard employment contract, etc.</p> <p>Planned Implementation: December 31, 2009</p> <p>Responsible Party: City Manager</p> |