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Hospitals Face Mandatory Affirmative Action Obligations Incorporated by Operation of Law Into Their Federal Subcontracts

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In UPMC Braddock v. Harris*, the U.S. District Court for the District of Columbia upheld the U.S. Department of Labor's Arbitration Review Board decision treating hospitals as government subcontractors subject to the equal opportunity clauses traditionally required to be flowed-down to federal government subcontractors, because those hospitals provided medical services to federal employees enrolled in an HMO plan offered by a federal agency. This court decision strikes new ground by incorporating affirmative action obligations into a* ***subcontract*** *by operation of law, even where the prime contract at issue expressly purported to exempt the hospitals from such coverage. In light of this decision, many hospitals (and other vendors) that traditionally have not considered themselves "subcontractors" subject to federal affirmative action requirements may now be subject to Department of Labor ("DOL") enforcement, depending on the nature of the services they provide to federal prime contractors.*

Background

Three hospitals affiliated with the University of Pittsburgh Medical Center contracted to provide medical services and supplies to individuals enrolled in the UPMC Health Plan, a health maintenance organization ("HMO"). UPMC Health Plan in turn contracted with the U.S. Office of Personnel Management ("OPM") to provide coverage to federal employees enrolled in the Federal Employees Health Benefits Program. The contract between UPMC Health Plan and OPM explicitly sought to exempt the hospitals from federal subcontractor status, defining the term "subcontractor" as "[a]ny supplier, distributor, vendor, or firm that

furnishes supplies or services to or for a prime contractor, or another subcontractor, **except for providers of direct medical services or supplies pursuant to the Carrier's health benefits plan"** (emphasis added). This contractual definition derived from OPM's Federal Acquisition Regulation Supplement § 1602.170-15. Based on this explicit contractual language, the hospitals – "providers of direct medical services or supplies" – presumed that they were not subcontractors subject to equal opportunity clauses that traditionally are required to be flowed down to subcontractors.

Hospitals Are Subcontractors

DOL asserted that the hospitals were subcontractors subject to affirmative action obligations, and the court agreed, rejecting four arguments by the hospitals. First, the court determined that the OPM provision in UPMC Health Plan's prime contract contradicted the regulations promulgated by DOL and was void. The court agreed with DOL that "neither the UPMC Health Plan nor a federal contracting agency is empowered to override the mandatory requirements of two federal statutes and an Executive Order."

The court was not persuaded by the hospitals' argument that the contractual exemption reflected OPM's definition of a "subcontractor." By statute and Executive Order Nos. 11246 and 11758, only DOL had been given authority to issue and administer the equal opportunity clauses to be incorporated into government contracts and subcontracts. OPM did not have that authority.

Instead, the court looked to the definition of subcontractor in DOL's regulations (and the materially identical version in FAR § 22.801 implementing DOL's regulations):

> **Subcontract** means any agreement or arrangement between a contractor and any person (in which the parties do not stand in the relationship of an employer and an employee):
>
> (1) For the purchase, sale or use of personal property or nonpersonal services which, in whole or in part, is necessary to the performance of any one or more contracts; or
>
> (2) Under which any portion of the contractor's obligation under any one or more contracts is performed, undertaken or assumed.

That definition contained no exemption for the provision of medical services, and thus, the court held, UPMC Health Plan and OPM could not create their own exemption by contract.

Second, the court rejected the hospitals' argument that they were providing **personal** services between doctor and patient and did not fit within the "nonpersonal services" of the definition above. The court disagreed because the FAR defines "personal services" as "characterized by the employer-employee relationship it creates between the Government and contractor's personnel." The court agreed with DOL that "the term 'nonpersonal services' does not refer to the nature of the interaction between the employees of a subcontractor and those individuals benefitting from the subcontract, as the hospitals would have it, but rather to the relationship between the subcontractor's personnel and the contracting government agency . . . ." The hospitals (and their doctors) did not become employees of the Government by providing these services and, thus, they were performing "nonpersonal services."

Third, the court rejected the hospitals' assertion that they neither performed services "necessary to the performance" of a government contract nor performed, undertook, or assumed a portion of the UPMC Health Plan's obligations under contract with OPM. Citing a U.S. Supreme Court case, the court determined that an HMO is neither "exclusively an insurance provider **[n]or** exclusively a health care

provider; it is both . . . .” Unlike a traditional medical insurer, UPMC Health Plan had contracted to serve as an HMO, not simply to provide insurance coverage. By taking on the role of an HMO, UPMC Health Plan’s contract with OPM required it to provide health care services. The hospitals provided UPMC Health Plan with the health care services to meet this obligation. The hospitals were providing necessary services to the performance and undertaking a portion of the obligations under the contract with OPM. Therefore, the court concluded the hospitals were covered federal subcontractors.

Mandatory Clauses Incorporated by Operation of Law to Subcontracts

Fourth, the court rejected the hospitals’ argument that they could not be subject to DOL enforcement because they had not consented to the equal opportunity clause provisions, which were not included in their contract with the UPMC Health Plan. The court held that DOL validly incorporated the mandatory clauses into the hospitals “subcontract” agreements with the UPMC Health Plan by regulation. Even though these clauses were not written into the contracts between the hospitals and UPMC Health Plan, DOL’s regulations expressly state: “By operation of the order, the equal opportunity clause shall be considered to be a part of every contract and subcontract required by the order and the regulations in this part to include such a clause **whether or not it is physically incorporated in such contracts and whether or not the contract between the agency and the contractor is written”** (emphasis added). The hospitals challenged the validity of these regulations as applied to subcontractors. The court rejected that challenge, upholding the validity of the regulations that expressly incorporate the clause into every contract and every subcontract. The *Christian* doctrine, named for the case originating it – *G.L. Christian & Assocs. v. United States,* 312 F.2d 418 (Ct. Cl. 1963) – has been relied on for 50 years as a basis for incorporation of mandatory contract clauses into a prime contract by operation of law where the clauses express a significant or deeply ingrained strand of public procurement policy. The hospitals argued, however, that, as subcontractors rather than prime contractors, “they never consented to do business with the federal government at all.” The court was unsympathetic to that argument, noting that UPMC had offered “no persuasive explanation of why the same constructive knowledge of federal procurement regulations should not also be imputed to subcontractors who undertake to provide services that support a government contract.” Accordingly, based on DOL’s “incorporation” regulation, the court held, for the first time, that incorporation of these mandatory clauses by operation of law applies equally to subcontracts with a federal contractor.

Impact

This decision is significant, not only to UPMC Health Plan, for several reasons:

First, hospitals providing health care to federal employees based on agreements with HMOs apparently now will be considered federal government subcontractors subject to these equal opportunity clauses and affirmative action obligations. (Notably, Congress statutorily exempted the Department of Defense’s TRI-CARE programs, so this ruling should not apply to TRI-CARE contracts and subcontracts.)

Second, the court’s decision could have far-reaching effects on many subcontract agreements. Subcontractors should take heed of the lesson that a federal prime contractor (or a covered federal subcontractor) cannot agree to exempt them from affirmative action obligations if the nature of the services provided falls under DOL’s regulatory definition of a covered subcontract. Instead, these equal opportunity clauses (and perhaps others) now may be incorporated by operation of law into subcontracts even where the prime contractor, subcontractor, and procuring agency never so intended.

Third, this decision reflects that DOL is aggressively defending – and, some might say, even attempting to enlarge – the scope of its enforcement authority. Those that do business with the federal government or with federal contractors thus would disregard DOL and FAR regulations at their peril.

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