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How Federal Funding Terms and Conditions Could Encourage Safe Artificial Intelligence Development

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About This Paper

In this paper, we examine policy and regulatory options available to the U.S. federal government to enforce safety and security requirements on artificial intelligence (AI) systems supported by U.S. government funds. We discuss implementing these requirements by establishing specific contractual conditions for recipients of federal contracts or requirements in grant-based funding, known as *terms and conditions*. We discuss several options for policymakers to consider in using terms and conditions to help implement requirements for AI systems while noting criticisms of such an approach. This paper should be of interest to the procurement and acquisition community, government implementors of AI systems, and AI system developers and vendors.

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How Federal Funding Terms and Conditions Could Encourage Safe Artificial Intelligence Development

The federal government's funding and purchasing power is one of its most significant tools in influencing how partners who receive such funds behave.¹ Clauses in federal contracts, known as *terms and conditions*, let the government stipulate certain activities that partners must perform to do business with the federal government. Many other federal programs that disburse money, such as grants and cooperative agreements, also include terms and conditions that must be met to receive funding, with their structure and requirements often tailored to the goals of each program.

For procurement, terms and conditions can be based on clauses in the Federal Acquisition Regulation (FAR) that stem from statutory and executive order requirements. Such requirements might also reflect national priorities dictated by Congress or the executive branch, such as awarding federal contracts to small businesses or buying domestically sourced products (i.e., "buy American" provisions). They might also be intended to protect the federal government from certain risks, such as foreign surveillance of U.S. telecommunications. However, terms and conditions have come under scrutiny because of their potential negative impacts. For example, the U.S. Government Accountability Office (GAO) and the Advisory Panel on Streamlining and Codifying Acquisition Regulations (known as the Section 809 Panel) have reported that terms and conditions can be burdensome for industry to meet and complicated for government contracting officials to implement.²

In November 2023, the Biden administration issued an executive order to help federal agencies manage risks associated with procuring artificial intelligence (AI) systems.³ As Congress and the executive branch consider options to oversee, regulate, and implement AI in federal agencies, the use of federal funding terms and conditions for AI presents both opportunities and challenges. In this paper, we examine past uses of federal funding terms and conditions, including past criticisms, and provide options for how such terms and conditions might be used by federal agencies in the context of procuring AI, including to support the implementation of federal law, executive orders, and agency-driven requirements.

¹ For the purposes of this paper, *partners* refers to industry, academia, partner nations, and others that do business with the federal government. In this paper, we largely focus on industry partners.

² Michael J. Sullivan, *Military Acquisitions: DOD Is Taking Steps to Address Challenges Faced by Certain Companies*, U.S. Government Accountability Office, GAO-17-644, July 20, 2017; Section 809 Panel, *Report of the Advisory Panel on Streamlining and Codifying Acquisition Regulations*, Vol. 1, January 2018.

³ Executive Order 14110, "Safe Secure, and Trustworthy Development and Use of Artificial Intelligence," Executive Office of the President, October 30, 2023.

Overview of Federal Funding Terms and Conditions

Federal agencies enter into contractual agreements with private sector firms, academic institutions, and partner nations, among others, to procure products and services necessary to achieve their missions. Although, in theory, this process is straightforward (see Figure 1), it can be complex. One aspect of the procurement process is the development and implementation of contractual terms and conditions. These terms and conditions identify specific requirements that private sector firms must meet to do business with the federal government. The process begins in the **pre-solicitation** phase with the government taking foundational steps for a procurement, including “identifying the need for contractor products or services, ensuring funding exists for contractor products or services, understanding the market, and developing documentation the acquisition office will need to issue a solicitation.”⁴ According to the Federal Acquisition Institute, contracting officials develop the solicitation, including the terms and conditions, during the **solicitation** phase after the government’s needs have been identified.⁵ As part of **source selection**, industry and the government must determine whether the firm bidding on the work can meet the terms and conditions set forth in the solicitation. It is then the responsibility of the private sector firm awarded the work to abide by the terms and conditions and of the government to oversee the execution of the contract during the **administration** phase.

Figure 1. Federal Acquisition Institute Procurement Life Cycle



SOURCE: Reproduced from Federal Acquisition Institute, 2015, p. 160.

Statutes, executive actions, and regulations have created a wide body of existing public policy– and socioeconomic-focused requirements attached to federal contracting actions. These include cybersecurity requirements for U.S. Department of Defense (DoD) contractors;⁶ regulations intended to prohibit transactions with countries, entities, and individuals who have been economically sanctioned by the U.S. government;⁷ regulations to prevent the use of trafficked labor for government contracts;⁸ participation goals and set-asides for small businesses;⁹ establishment of a minimum wage

⁴ Federal Acquisition Institute, *Project Manager’s Guidebook*, November 24, 2015, pp. 160–161.

⁵ Federal Acquisition Institute, 2015, p. 169.

⁶ Office of the Department of Defense Chief Information Officer, Department of Defense, “Cybersecurity Maturity Model Certification (CMMC) Program,” *Federal Register*, Vol. 88, No. 246, December 26, 2023.

⁷ FAR, Part 25, Foreign Acquisition; Subpart 25.7, Prohibited Sources, which implemented economic sanctions administered by the Office of Foreign Asset Control and various federal laws.

⁸ FAR, Part 22, Application of Labor Laws to Government Acquisitions; Subpart 22.17, Combating Trafficking in Persons, which implemented U.S. Code, Title 22, Chapter 78, Trafficking Victims Protection, and Executive Order 13627, “Strengthening Protections Against Trafficking in Persons in Federal Contracts,” Executive Office of the President, September 25, 2012.

⁹ FAR, Part 19, Small Business Programs, which implemented various federal laws and executive orders.

for federal contract employees;¹⁰ and encouragement to contractors to prohibit their employees from using a mobile device to send text messages while driving.¹¹ For example, statutory requirements enacted in 2019 prohibit the federal government from buying products or services from firms that use telecommunications and video surveillance systems from certain Chinese companies.¹² To cite another example, in 2021, Executive Order 14028 required federal agencies to design contract language and requirements to ensure that service providers (1) collect and preserve information “relevant to cybersecurity event prevention, detection, response, and investigation on all information systems over which they have control, including systems operated on behalf of agencies”; (2) “share such data”; and (3) “collaborate with Federal cybersecurity or investigative agencies.”¹³

These existing agency requirements provide two models that could be drawn from by Congress and the executive branch in formulating funding requirements and articulating the need for such rules for AI acquisitions.¹⁴ For example, the prohibition against certain Chinese telecommunications equipment demonstrates how **statutory requirements can be implemented through amendments to the FAR**, among other actions. In August 2018, the National Defense Authorization Act for Fiscal Year 2019 became law. Section 889 of this law directed federal agencies to prohibit procuring certain equipment or contracting with organizations that use such equipment.¹⁵ To implement these requirements, the FAR Council issued four interim rules covering the key provisions of section 889 in 2019 and 2020.¹⁶ As part of the process, public comments were also obtained after the interim rules went into effect. As this example demonstrates, modifying the FAR requires a notice and comment period under federal rulemaking processes, which can be lengthy.

Executive orders can also result in alterations to the FAR. For example, Executive Order 14028, “Improving the Nation’s Cybersecurity,” sought to improve cybersecurity and information-sharing between contractors and the government by requiring, among other things, cybersecurity incident data to be tracked and shared with the government.¹⁷ To help achieve this goal and embed such requirements in federal contracts, Executive Order 14028 ordered the FAR Council to consider amending the FAR based on recommendations issued by the Secretary of Homeland Security. These

¹⁰ Executive Order 14026, “Increasing the Minimum Wage for Federal Contractors,” Executive Office of the President, April 27, 2021.

¹¹ FAR, Part 26, Other Socioeconomic Programs; Subpart 26.6, Encouraging Contractor Policies to Ban Text Messaging While Driving, which implemented Executive Order 13513, “Federal Leadership on Reducing Text Messaging While Driving,” Executive Office of the President, October 1, 2009.

¹² See Public Law 115-232, John S. McCain National Defense Authorization Act of Fiscal Year 2019, Section 889, Prohibition on Certain Telecommunications and Video Surveillance Services or Equipment, August 13, 2018, and the accompanying FAR rule published in July 2020 (FAR, Part 52, Solicitation Provisions and Contract Clauses; Subpart 52.204, Prohibition on Contracting for Certain Telecommunications and Video Surveillance Services or Equipment).

¹³ Executive Order 14028, “Improving the Nation’s Cybersecurity,” Executive Office of the President, May 12, 2021.

¹⁴ Executive Order 14028, 2021; see also Executive Order 14030, “Climate-Related Financial Risk,” Executive Office of the President, May 20, 2021 (which requires government contractors to disclose risks from climate change) and Moshe Schwartz, “Social and Economic Public Policy Goals and Their Impact on Defense Acquisition—A 2019 Update,” *Defense Acquisition Research Journal*, Vol. 26, No. 3, July 2019.

¹⁵ Jill C. Gallagher, *U.S. Restrictions on Huawei Technologies: National Security, Foreign Policy, and Economic Interests*, Congressional Research Service, R47012, January 5, 2022.

¹⁶ Acquisition.gov, “Section 889 Policies,” webpage, undated.

¹⁷ Executive Order 14028, 2021.

efforts resulted in a proposed rule issued in 2023 by the FAR Council to require significant improvements to contractors' cybersecurity and incident reporting practices, including proposing that contractors maintain a "software bill of materials" that tracks the provenance and supply chain relationships of components of software that they provide to the federal government.¹⁸ These requirements demonstrate the federal government's ability to require specific development practices from contractors to meet goals, such as ensuring security, and provide a model for the potential implementation of those practices through the FAR.

The FAR serves as an implementation playbook that contracting officials must follow in acquiring goods and services on behalf of executive branch agencies. It establishes basic policy for the solicitation and procurement processes; sets applicable requirements (such as sourcing certain categories of goods from U.S. entities where possible) and excluded sources; and provides standard or optional clauses for inclusion, or incorporation by reference, in solicitations and contracts. The FAR also authorizes government officials to "use any 'specific strategy, policy, or procedure' not addressed by the FAR so long as the strategy, policy or procedure is in the best interest of the government, and is not prohibited by statute, regulation, executive order, or case law."¹⁹ This authority might allow agencies to create terms and conditions related to procurement of AI products and services without amending the FAR.

Promoting Safe AI Development Practices Beyond Procurement

The federal government disburses funds through a variety of funding mechanisms other than procurement spending, such as grants. These programs represent another potential mechanism for the government to use to encourage safe and secure AI development. Such programs often specify their requirements in their enabling statutes, and these requirements might be developed by the implementing agency, such as the requirements to receive funding from the Creating Helpful Incentives to Produce Semiconductors (CHIPS) for America International Technology Security and Innovation Fund developed by the U.S. Department of Commerce.²⁰ Grant programs also fund scientific research through such organizations as the National Science Foundation and the National Institutes of Health.

The federal government has also used terms and conditions to encourage responsible behavior by companies and researchers that do not sell products and services to the government but are nonetheless supported by federal activity. For example, the "Common Rule," codified as Code of Federal Regulation, Title 45, Part 46, regulates all scientific research involving human subjects that is "conducted, supported, or otherwise subject to regulation by any Federal department or agency" and

¹⁸ Department of Defense, General Services Administration, National Aeronautics and Space Administration, "Federal Acquisition Regulation: Cyber Threat and Incident Reporting and Information Sharing," *Federal Register*, Vol. 88, No. 190, October 3, 2023.

¹⁹ Erika K. Lunder, L. Elaine Halchin, and Michelle D. Christensen, *The Federal Acquisition Regulation (FAR): Answers to Frequently Asked Questions*, Congressional Research Service, R42826, December 18, 2015, p. 28.

²⁰ National Institute of Standards and Technology, "Notice of Funding Opportunity (NOFO): CHIPS Incentives Program—Commercial Fabrication Facilities," June 23, 2023.

subjects such research to a series of ethical and safety requirements.²¹ The federal government could require similar safety rules in federally funded AI research—for example, security precautions to secure AI research that touches on sensitive national security topics, such as cybersecurity.²²

If the federal government aims to comprehensively regulate safe AI development, funding terms and conditions cannot entirely substitute for regulation. Not all AI developers may be interested in federal funding opportunities, and, therefore, they have no incentive to implement practices embedded in such conditions to qualify for such funding opportunities. In addition, some behaviors that the government might wish to oversee, such as the deployment of AI for marketing or algorithmic recommendations, might be better addressed through new legislation or agency rulemaking to ensure that all AI companies are following the same set of practices or are restricted from engaging in behaviors that the government deems to be negative.

Prior Criticisms of Terms and Conditions on Federal Funding

Although terms and conditions have become a mainstay in federal contracting, their use by the federal government, especially DoD, has been criticized as being onerous and a hindrance to industry. In July 2017, GAO reported that “like other federal agencies, DOD includes standard terms and conditions in its contracts that are unique to the government that some companies we spoke to believe would add significant cost or add little value to the transaction.”²³ GAO found that terms and conditions were viewed as overly burdensome both by companies that are accustomed to doing business with the federal government and by those that are not. As a result of terms and conditions, companies received lower rates of return for federal contracts than for commercial contracts. In one example, a firm declined an award because “it could no longer effectively manage the large amount of federal requirements included in the contract clauses.”²⁴

The findings of the Section 809 Panel corroborated GAO’s findings. The Section 809 Panel noted that “[c]ontracting with the federal government to sell commercial products and services needs to be much simpler and more closely reflect standard commercial practices, especially regarding use of unique terms and conditions imposed on commercial suppliers to the federal government.”²⁵ The panel also acknowledged that contracting officers must balance compliance with terms and conditions against the need to ensure timely delivery of the necessary capability to DoD personnel.²⁶ Terms and conditions can create additional complexities for the private sector and potentially disincentivize companies unaccustomed to federal procurement processes from entering the federal market. Such concerns might also arise with AI, because AI developers might lack the expertise and experience to navigate federal contracting requirements. In addition, new conditions for AI might be difficult to

²¹ Code of Federal Regulations, Title 45, Public Welfare; Subtitle A, Department of Health and Human Services; Subchapter A, General Administration; Part 46, Protection of Human Subjects.

²² See Sella Nevo, Dan Lahav, Ajay Karpur, Yogev Bar-On, Henry Alexander Bradley, and Jeff Alstott, *Securing AI Model Weights: Preventing Theft and Misuse of Frontier Models*, RAND Corporation, RR-A2849-1, 2024.

²³ Sullivan, 2017, p. 15.

²⁴ Sullivan, 2017, p. 17.

²⁵ Section 809 Panel, 2018, p. 38.

²⁶ Section 809 Panel, 2018, p. 62.

implement, because the rapid evolution of the technology means that conditions that are too specific might quickly become obsolete and unduly burdensome for developers seeking to sell to government customers. For these reasons, the costs and benefits should be carefully weighed when considering adding new terms and conditions.

Terms and Conditions and Recent Executive Branch Guidance on Federal AI Procurement

To implement various statutes and Executive Order 14110,²⁷ which are related to the implementation of AI, the Office of Management and Budget (OMB) issued guidance in March 2024 that provides recommendations to federal agencies on procurement of AI systems.²⁸ Specifically, OMB recommends actions that agencies should consider taking to manage risks of procuring AI systems. Agencies are recommended to

- ensure that AI procurements adhere to relevant laws, regulations, and policies associated with “privacy, confidentiality, intellectual property, cybersecurity, human and civil rights, and civil liberties”
- obtain documentation on the AI system to understand capabilities and limitations of the system and its data
- evaluate the AI system’s effectiveness and test it in a real-world environment
- “incentivize the continuous improvement of procured AI” through contract provisions
- conduct monitoring post-award
- promote competition
- “protect Federal information used by vendors in the development and operation of AI products and services”
- assess various risks related to systems using biometrics to identify individuals
- “include risk management requirements in contracts for generative AI”
- consider environmental impacts of AI services relying on dual-use foundation models.²⁹

Numerous other requirements stemming from this guidance and the underlying statutes and executive order could provide further opportunities to design terms and conditions to help ensure the implementation of these requirements. Specifically, agencies could craft terms and conditions to help address the minimum practices for “rights-impacting” and “safety-impacting” AI, as outlined in the OMB guidance.³⁰ These minimum practices as described by OMB include

²⁷ These included the AI in Government Act of 2020 (U.S. House of Representatives, AI in Government Act of 2020, Bill 2575, September 14, 2020), Advancing American AI Act (U.S. Senate, Advancing American AI Act, Bill 1353, April 22, 2021), and Executive Order 14110, 2023.

²⁸ Shalanda D. Young, “Advancing Governance, Innovation, and Risk Management for Agency Use of Artificial Intelligence,” memorandum for the heads of executive departments and agencies, Executive Office of the President, Office of Management and Budget, March 28, 2024.

²⁹ Young, 2024, pp. 24–26.

³⁰ See Section 6 of Young, 2024, for definitions of *rights-impacting* and *safety-impacting* AI.

- AI impact assessment
- real-world AI performance testing
- independent AI evaluations
- ongoing monitoring
- regular AI risk evaluations
- mitigation of emerging risks to rights and safety
- training and assessment of AI operators
- provision of human intervention processes
- provision of public notice and plain-language documents.³¹

The OMB guidance noted that it will develop “an initial means to ensure that Federal contracts for the acquisition of an AI system or service align with the guidance.”³²

Mechanisms to Authorize the Use of Terms and Conditions for AI

This section is intended to describe the mechanisms that authorize agencies to use terms and conditions to help oversee the procurement and implementation of AI systems. These mechanisms are shown in Table 1.

Table 1. Possible Authorities to Address AI Safety and Security in Terms and Conditions

Authorizing Mechanism	Description
Statute	Federal law could require changes to the FAR and implementation of terms and conditions in federal contracts.
Executive order	The executive branch could issue guidance in the form of an executive order to direct changes to the FAR and adoption of terms and conditions in federal contracts.
Agency-led	Agencies could develop terms and conditions under the existing authority in the FAR.
Common rule–like mechanism	Statutes or federal rulemaking could create requirements for AI research and other forms of government funding outside the procurement process.

As Congress weighs numerous pieces of legislation governing AI, some recent legislation proposes using terms and conditions to address AI safety and security through various means. Illustrative examples include

- the Federal Artificial Intelligence Risk Management Act, which would require the Administrator of the Office of Federal Procurement Policy to provide federal agencies with draft contract language to use in procurement that requires an AI supplier to follow the

³¹ Young, 2024, pp. 17–21.

³² Young, 2024, p. 24.

National Institute of Standards and Technology AI Risk Management Framework and provide necessary information to federal agencies to perform testing and evaluation³³

- the Federal AI Governance and Transparency Act, which would, among other things, require changes to the FAR to require contractors to provide certain information to federal agencies³⁴
- the Promoting Responsible Evaluation and Procurement to Advance Readiness for Enterprise-wide Deployment for Artificial Intelligence Act, or PREPARED for AI Act, which would require changes to the FAR to ensure that certain steps are followed before federal agencies procure AI systems.³⁵

Given the significance that terms and conditions might have on future AI procurements, the federal government will need to carefully balance managing the safety and security risks this new technology might pose with taking advantage of innovative capabilities in industry that could transform government operations and not unduly burden potential suppliers. This balance requires consideration of how best to address past criticisms of federal uses of terms and conditions while promoting consistency in the way terms and conditions are used. For example, the administration might decide to amend the FAR to implement consistent terms and conditions for AI, which would reduce complexities and ensure consistency among federal agencies, although this option would take time to implement. Federal procurement officials might also seek to align new terms and conditions for procurement of AI systems and services with existing statutory, regulatory, and executive order requirements with which industry is familiar. Using responsible terms and conditions—and doing so in a way that addresses some of the critiques made in the past—could help agency leaders both manage AI risks and continue to promote AI innovation.

³³ See U.S. Senate, Federal Artificial Intelligence Risk Management Act of 2023, Bill 3205, November 2, 2023. The House's companion bill is U.S. House of Representatives, Federal Artificial Intelligence Risk Management Act of 2024, Bill 6936, January 10, 2024.

³⁴ See U.S. House of Representatives, Federal AI Governance and Transparency Act, Bill 7532, March 5, 2024.

³⁵ See U.S. Senate, PREPARED for AI Act, Bill 4495, June 11, 2024.

Abbreviations

AI	artificial intelligence
DoD	U.S. Department of Defense
FAR	Federal Acquisition Regulation
GAO	U.S. Government Accountability Office
OMB	Office of Management and Budget

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