

AN A.S. PRATT PUBLICATION

APRIL 2017

VOL. 3 • NO. 4

PRATT'S
**GOVERNMENT
CONTRACTING
LAW**
REPORT



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Library of Congress Card Number:

ISBN: 978-1-6328-2705-0 (print)

Cite this publication as:

[author name], [article title], [vol. no.] PRATT’S GOVERNMENT CONTRACTING LAW REPORT [page number] (LexisNexis A.S. Pratt);
Michelle E. Litteken, GAO Holds NASA Exceeded Its Discretion in Protest of FSS Task Order, 1 PRATT’S GOVERNMENT CONTRACTING LAW REPORT 30 (LexisNexis A.S. Pratt)

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An A.S. Pratt® Publication

Editorial Office
230 Park Ave., 7th Floor, New York, NY 10169 (800) 543-6862
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New FAR Changes Incentivize Prime Contractors Not to Be Deadbeats in Meeting Their Payment Obligations to Their Small Business Subcontractors

*By Daniel J. Kelly**

New changes to the Federal Acquisition Regulation now impose mandatory reporting obligations on primes should they fail to make timely and full payments to their small business subs. The author of this article explains the changes.

One common complaint often heard from subcontractors is “How can we get paid?”

Whether through inadvertence, lack of subcontract management resources—or even as a predatory business strategy—some prime contractors will dance, dither, and delay upon receipt of requests for payment by their subs for work performed, services rendered and/or products delivered. This can be particularly onerous for small business subcontractors whose payroll and other obligations depend upon prompt payment by their customers.

Subs are put in an untenable position. Should they stop work and risk breach of contract? Should they threaten to sue and risk breaching the relationship? New changes to the Federal Acquisition Regulation (“FAR”) now impose mandatory reporting obligations on primes should they fail to make timely and full payments to their small business subs. Chronic and unjustified payments now must go into an agency’s evaluation of the prime’s past performance in bidding contests.

Primes are well advised to make sure their supply chain management is in order to minimize the additional obligations and risks confronting them should they fail to meet their obligations to their small business subs.

BACKGROUND

Although contracting officers have no authority to direct payments to subcontractors, both Congress and the regulating agencies have adopted a series of measures to aid subcontractors in getting paid. The Miller Act¹ authorizes

* Daniel J. Kelly is a partner at McCarter & English, LLP, counseling and acting as an advocate on behalf of clients doing business in the government marketplace. He may be reached at dkelly@mccarter.com.

¹ 40 U.S.C. §§ 3131–3134.

subs providing labor or materials on federal constructions projects to bring civil actions against prime contractors' payment bonds.

The Prompt Payment Act, first enacted in 1982 in response to delays by agencies in paying primes, was amended in 1988 to require agencies to include a clause² in federal constructions contracts to pay the sub for "satisfactory" performance within seven days of receipt of payment from the agency, and to pay an interest penalty if payments are not satisfactorily made.³

In November 2013, following guidance memoranda issued by the Office of Management and Budget, the FAR was amended to require a mandatory clause for all contracts,⁴ providing that upon receipt of accelerated payments from a government agency, the prime must accelerate payments to its small business subcontractors "to the maximum extent practicable and prior to when such payment is otherwise required under the subcontractor."⁵

FAR CHANGES

Newly minted FAR Clause 52.242-5 and its related regulations and clauses, effective January 19, 2017, are the latest. The clause is now mandatory for all prime contracts requiring a Small Business Subcontracting Plan (currently contracts valued over \$700,000 and public facility construction contracts over \$1.5 million), and establishes a reporting requirement for any late or reduced contract payments by a prime to its first-tier subcontractors.⁶

Under the new clause, the *prime must notify the contracting officer* in writing and within 14 days after:

- (1) the small business subcontractor was entitled to payment under its subcontract; and
- (2) the prime made a *reduced* or untimely payment to the subcontractor or failed to make a payment which is now *untimely*.

FAR 52.242-5 defines "reduced" as a payment for less than the amount agreed upon. "Untimely" means a payment that is more than *90 days* past due under the terms and conditions of the contract. The notice must include the reasons for making the reduced or untimely payment.

FAR 19.704 and FAR Clause 52.219-9, governing Small Business Subcontracting Plans, has also been amended to require prime contractors to include

² FAR Clause 52.232-27(c).

³ See 31 U.S.C. § 3905(b).

⁴ FAR Clause 52.232-40.

⁵ See FAR 32.009.

⁶ See 81 Fed. Reg. 93481 (December 20, 2016).

in their Small Business Subcontracting Plans “[a]ssurances that [the contractor] will pay its small business subcontractors on time and in accordance with the terms and conditions of the underlying contract, and [the obligation to] notify the contracting officer when the prime contractor makes a reduced or untimely payment to a small business subcontractor (see 52.242-5).” *That means that primes have an immediate obligation to revise their Small Business Subcontracting Plan to include this requirement.*

Finally, FAR Part 42.1502, establishing the policy for past performance evaluations, has been amended to require that such evaluations include an assessment of reduced or untimely payments to small business subcontractors determined to be “unjustified.”

In particular, the contracting officer must assess whether the contractor’s written explanation passes muster and must determine whether there is a “history of unjustified reduced or untimely payments” exemplified by a contractor reporting three or more occasions of unjustified reduced or untimely payments under a single contract within a one-year period.

A payment is not considered “unjustified” if there is a contract dispute regarding performance, a partial payment is made for amounts not in dispute, a payment is reduced due to past overpayments, there is an “administrative mistake,” or late performance of the contractor leads to later payment by the prime. Once such a determination is made, the information must be reported in the Federal Awardee Performance and Integrity Information System (“FAPIIS”)—the government-wide database used to track contractor misconduct and performance—within three calendar days.

The obligation was already enshrined in law (in amendments to the Small Business Act in 2010)⁷ and follows proposed rules dating back to July 2013. Importantly, already on the books and promulgated following the 2010 amendments to the Small Business Act is a Small Business Administration regulation prohibiting prime contractors from restricting a subcontractor from “discussing any material matter *pertaining to payment or utilization with the contracting officer.*”⁸ This sends a strong signal that there is a channel for subcontractors to alert agencies when they are not being paid on a timely basis.

CONCLUSION

Failure of a prime contractor to pay the full amount owed (at least within 90 days of the due date) in conjunction with the failure to report it will be a breach

⁷ P.L. 111-240, 124 Stat. 2504 (September 27, 2010) codified at 15 U.S.C. § 637(d)(12)(B).

⁸ 13 C.F.R. 125.3(c)(1)(iii) (emphasis added).

of the prime contract—a fact which an aggressive subcontractor may well want to bring to the attention of both the prime and the contracting agency. Chronic and unexcused failures to pay will now be part of the calculus used in evaluating past performance in new solicitation on which the prime is bidding.

For these reasons, primes are well advised to take seriously these new obligations and build into their supply chain management system checks and balances to ward off unjustified nonpayments or reduced payments.