March 21, 2016

Via Regulations.gov

General Services Administration
Regulatory Secretariat Division (MVCB)
Attn: Ms. Hada Flowers
1800 F Street, NW, 2nd Floor
Washington, D.C. 20405


Dear Ms. Flowers:

On behalf of the American Bar Association (“ABA”) Section of Public Contract Law (“Section”), I am submitting comments on the Federal Acquisition Regulation (“FAR”) proposed rule.1 The Section consists of attorneys and associated professionals in private practice, industry, and government service. The Section’s governing Council and substantive committees include members representing these three segments to ensure that all points of view are considered. By presenting their consensus view, the Section seeks to improve the process of public contracting for needed supplies, services, and public works.

The Section is authorized to submit comments on acquisition regulations under special authority granted by the ABA’s Board of Governors. The views expressed herein have not been approved by the House of Delegates or the Board of Governors of the ABA and, therefore, should not be construed as representing the policy of the ABA.2

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1 Mary Ellen Coster Williams, Section Delegate to the ABA House of Delegates, and Heather K. Weiner, member of the Section’s Council, did not participate in the Section’s consideration of these comments and abstained from the voting to approve and send this letter.

2 This letter is available in pdf format at http://www.americanbar.org/groups/public_contract_law/resources/prior_section_comments.html under the topic “Small Business and Socioeconomic Issues.”
I. INTRODUCTION

Section 1334 of the Small Business Jobs Act of 2010 (Pub. L. 111-240) (the “Jobs Act”) modified the Small Business Act to require a prime contractor to self-report to the contracting officer when the prime contractor makes untimely or reduced payments to small business subcontractors. In addition, the Jobs Act requires the contracting officer to record the identity of contractors with a history of late or reduced payments to small-business subcontractors in the Federal Awardee Performance and Integrity Information System (“FAPIIS”).

On January 20, 2016, the FAR Council released the proposed rule to implement these requirements of the Jobs Act. The FAR Council has determined that the proposed rule should apply to contracts for commercial items and commercially available off-the-shelf (“COTS”) items under the commercial-item and COTS exemptions in 41 U.S.C. §§ 1906(b)(2) and 1907(a)(2). Although the FAR Council acknowledged that the Jobs Act is silent regarding application of this requirement to commercial item or COTS contracts, it made a written determination that “it is not in the best interest of the Federal Government to exempt the acquisition of commercial items from the provision of law.”

The Section appreciates the opportunity to provide comments on the proposed rule, which, as currently drafted, would be difficult for commercial-item and COTS contractors to implement and would impose significant costs and burdens on contractors generally. The Section believes that the proposed rule should not be extended to commercial-item and COTS contracts, and, if it is, the scope of reporting under the proposed rule should be limited. The Section further believes that the FAR Council should clarify certain definitions in the proposed rule to align more closely with the Administration’s identified goals.

II. COMMENTS

The Section recognizes the key role small businesses play in supporting the federal procurement system and applauds the FAR Council for taking steps to ensure small businesses are not subjected to unjustified late or reduced contract payments. The Section believes that the proposed rule will help reduce cases in which contractors unjustifiably pay their small business subcontractors late, or pay them less than they are due under the subcontract. Nonetheless, the Section believes that the proposed rule would benefit from several clarifications as described below.

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4 See id.
5 See id. at 3088.
A. The Proposed Rule Should Be Revised to Exclude Commercial Item and COTS Contracts.

As acknowledged by the FAR Council, the Jobs Act is silent regarding whether the Proposed Rule should apply to commercial-item and COTS contractors.6 The FAR Council nonetheless determined that the proposed rule should apply to contracts for commercial items and COTS based on three factors:

(i) The benefits of the policy in furthering Administration goals, (ii) the extent to which the benefits of the policy would be reduced if an exemption is provided for commercial items, and (iii) the burden on contractors if the policy is applied to acquisitions for commercial items.7

Although the Section agrees that the proposed rule furthers the Administration’s goals, it believes that the FAR Council has greatly underestimated the implementation burden on commercial-item and COTS contractors, especially considering the broad definition of “subcontractor” that applies to the proposed rule. The Section believes that the estimate of reporting time of only two hours per respondent is grossly underestimated.8 This negligible amount of time necessarily assumes that all contractors can easily identify from their payment systems which subcontractors are small businesses. The Section believes that this is often not the case. Quite frequently, the small-business size status of a subcontractor may be known by the contractor’s purchasing department, but that information frequently is not included in the contractor’s other accounting systems, such as accounts payable. Accordingly, contractors not presently able to identify from their payment systems which subcontractors are small-business subcontractors will need to either (a) invest in new systems that communicate this information to accounts payable, (b) modify, to the extent possible, their existing systems, or (c) perform a potentially extensive manual exercise to match small-business size status to qualifying payments as just the first step to identify which payments should be reported to the contracting officer.

The FAR Council relies on similar factors to justify applying the proposed rule to COTS contractors.9 The analysis relies largely on the fact that COTS contractors are not exempt from the subcontracting plan requirements under FAR 52.219-9. Nevertheless, given the Government’s stated preference for “commercial plans” in FAR 52.219-9(g) for commercial item contractors (including COTS contractors), it is likely that most commercial item and COTS contractors have commercial subcontracting plans. These commercial plans apply to the contractor’s entire commercial organization, which in many cases, includes only a minimal amount of sales to the federal government. Furthermore, these commercial plans apply to virtually every subcontractor or supplier from which a contractor purchases supplies or services,

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6 Id. at 3088, 3089.
7 Id. at 3088.
8 See id.
9 See id. at 3089.
whether or not those supplies or services are used in the performance of government contracts. Accordingly, contractors may be required to report certain payments to small-business subcontractors that may have, at best, a tenuous connection to federal government purchases.

The Section encourages the FAR Council to reconsider the application of the proposed rule to commercial item and COTS contractors. Alternatively, the Section suggests that the proposed rule apply only to commercial-item and COTS contractors with individual subcontracting plans and not commercial subcontracting plans. This alternative change would ensure that the obligations of the proposed rule directly relate to payments made to small-business contractors supporting federal government contracts. As a further alternative, as discussed below, the Section encourages that the proposed rule be revised to include a narrower definition of “subcontract.”

B. The Proposed Rule Would Benefit From Clarification of Key Terms.


The proposed rule would modify FAR 19.701 to add a definition of “untimely payment” that reads as follows:

Untimely payment means a payment to a subcontractor that is more than 90 days past due under the terms and conditions of a subcontract, for supplies and services for which the Government has paid the prime contractor.10

The Section believes that the proposed rule should contain an additional clarification that a payment should not be considered past due if the payment is delayed by the late performance of the subcontractor. Contractors often accept late performance of subcontracts and then accordingly pay later according to the payment terms of the subcontract, but do not necessarily modify the subcontract to reflect the later performance date. We would also recommend including a condition of timely payment by the Government in the definition. If the Government is late in making its payment, the prime contractor should not be held accountable for late payment to the subcontractor unless the prime contractor’s obligation to pay is triggered by payment by the Government.

2. The Section Recommends Clarifying What Constitutes a “Reduced Payment.”

The proposed rule would modify FAR 19.701 to add a definition of “reduced payment” that reads as follows:

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10 Id. at 3090.
Reduced payment means a payment that is for less than the amount agreed upon in a subcontract in accordance with its terms and conditions, for supplies and services for which the Government has paid the prime contractor.\textsuperscript{11}

The Section believes that the proposed rule should also clarify that a payment is not considered reduced if the reduction is made according to the terms of the contract and if the facts justify the reduction. There are several reasons why a subcontract payment may be reduced from the original contract price. Consider the following examples:

- Prime contractors often auto-pay subcontractors upon receipt of goods at the contractor’s location. If it is later determined that the subcontractor under-shipped, the prime contractor often will withhold the value of the under-shipped goods from the next payment due the subcontractor.

- After paying a subcontractor for goods, the prime contractor may inspect the goods and reject them as nonconforming under the contract. The prime contractor in such a case will often withhold the value of the nonconforming goods from the next payment due the subcontractor.

- Subcontracts may contain liquidated damages provisions for late or defective goods that provide for a reduction in contract price.

- Subcontracts may provide for the acceptance of defective or nonconforming goods at a reduced price.

- Subcontracts often contain set-off and recoupment clauses that permit the prime contractor to reduce or withhold payment because of amounts due or recoverable under other subcontracts with the subcontractor.

None of the foregoing situations should be considered as a reduced payment for the purposes of the proposed rule. The situations cited above are only a few examples of situations that occur routinely where prime contractors may pay their subcontractors less than the subcontract price. The Section believes that a payment should be considered reduced only if the prime contractor is not entitled per the terms of the subcontract to pay less than the original subcontract price.

3. The Section Recommends Clarifying the Definition of “Subcontract.”

If the FAR Council determines that the proposed rule will continue to apply to commercial item and COTS contracts, the Section recommends that the definition of “subcontract” be narrowed to alleviate the potential reporting burdens that would apply to commercial-item and COTS contractors under the proposed rule as currently drafted. The Section recommends that the definition limit “subcontracts” for reporting purposes to those that

\textsuperscript{11} Id.
directly support a federal prime contract and are not purchases in support of the commercial organization as a whole.

C. **Past Performance Evaluations for Untimely or Reduced Payments Should Take into Consideration the Number of Payments a Contractor Makes.**

Section 1334 of the Jobs Act also provides that the contracting officer for a covered contract shall consider the unjustified failure by a prime contractor to make a full or timely payment to a subcontractor in evaluating the performance of the prime contractor.

The proposed rule goes further than the statute, and would modify FAR 42.1502 to define a contractor as having a “history of unjustified reduced or untimely payments has occurred when the contractor has reported three or more occasions of unjustified reduced or untimely payments under a single contract within a 12 month period.”12 This formulation ignores the relationship of the number of unjustified reduced or untimely payments to the total number of payments a contractor makes during a 12 month period. The Section believes that contracting officers should consider the total number of subcontractor payments a prime contractor makes in determining whether the prime contractor has a history of unjustified reduced or untimely payments rather than focusing only on whether it has made three such payments during a 12 month period.

III. **CONCLUSION**

The Section appreciates the opportunity to provide these comments and is available to provide additional information or assistance as you may require.

Sincerely,

David G. Ehrhart
Chair, Section of Public Contract Law

cc:
James A. Hughes
Aaron P. Silberman
Kara M. Sacilotto
Jennifer L. Dauer
Council Members, Section of Public Contract Law
Chairs and Vice Chairs, Commercial Products and Services Committee
Chairs and Vice Chairs, Small Business and Other Socioeconomic Programs Committee
Chairs and Vice Chairs, Subcontracting, Teaming and Strategic Alliances Committee
Craig Smith
Samantha S. Lee

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12 *Id.*