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AGC of America
THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA
Quality People. Quality Projects.



March 21, 2016

Ms. Hada Flowers
Regulatory Secretariat Division
General Services Administration
1800 F Street N.W., Second Floor
Washington, D.C. 20405

RE: FAR Case 2014-004; Payment of Small Business Subcontractors Proposed FAR Rule

Dear Ms. Flowers,

On behalf of the Associated General Contractors of America (AGC), I would like to thank you and the Federal Acquisition Regulation (FAR) Council for soliciting comments on requiring prime contractors to self-report to the contracting officer when the prime contractor makes late or reduced payments to small business subcontractors. AGC believes that all contractors—whether paid directly by the government or another contractor—should receive timely and adequate payment for quality work performed. That stated, AGC believes that the existing statutory and regulatory requirements governing prime contractor and subcontractor payments already satisfy the intent of this proposed regulation. In addition, AGC has a number concerns about the proposed rule's requirements set forth to implement this approach.

AGC is the leading association for the construction industry, representing both union and non-union prime and subcontractor/specialty construction companies. AGC represents more than 26,000 firms including over 6,500 of America's leading general contractors and over 9,000 specialty-contracting firms. More than 10,500 service providers and suppliers are also associated with AGC, all through a nationwide network of chapters. AGC contractors are engaged in the construction of the nation's commercial buildings, shopping centers, factories, warehouses, highways, bridges, tunnels, airports, waterworks facilities, waste treatment facilities, dams, water conservation projects, defense facilities, multi-family housing projects, site preparation/utilities installation for housing development, and more.

First, these comments will explain the payment process on federal government construction contracts, and highlight the fact that existing contractor payment statutes and regulations already provide sufficient protections for subcontractor payment. Then, the comments will address particular issues with the FAR Council's proposed rule.

I. Payment Processes Under Federal Construction Contracts

Payment for work completed on federal construction contracts begins with the government making timely and sufficient payment to prime contractors who, in turn, make timely and sufficient payment to their subcontractors for work performed. First, these comments will address federal government payment to prime contractors. Then, these comments will address federal prime contractor payments to subcontractors.

A. General Background On Federal Government Payment To Prime Construction Contractors

The federal government makes payment to prime contractors in two ways: (1) prime contractor invoicing; and (2) progress payments. FAR § 52.232-5 governs payments for fixed price construction contracts—the vast majority of federal construction contracts. This provision sets forth the prime contractor’s responsibilities for submitting proper invoices in order for the federal government to make timely and proper payment. This FAR provision also states that the government shall make progress payments on a monthly basis based on the estimates of accomplished work that meets the standards of quality established under the contract, as approved by the contracting officer. Along with each progress payment request, the contractor must certify that the request for payment only includes work performed within the specifications and terms and conditions of the contract. In addition, the contractor must certify that it has not billed for any amounts that it intends to withhold or retain from a subcontractor or supplier in accordance with the terms and conditions of the subcontract.

As to retainage,¹ if the contracting officer finds that satisfactory progress was achieved during any period for which a progress payment is to be made, the contracting officer must authorize payment to be made in full. However, if satisfactory progress has not been made, the contracting officer may retain a maximum of 10 percent of the amount of payment as retainage until satisfactory progress is achieved. In addition to work performed, the federal government shall, upon request, reimburse the contractor for the amount of premiums paid for performance and payment bonds after the contractor has furnished evidence of full payment to its surety.

Final payment on a fixed-price construction contract requires three elements to be satisfied: (1) the completion and acceptance of all work; (2) the presentation of a properly executed voucher; and (3) the execution of a release of all claims against the government arising by virtue of the contract, other than claims, in stated amounts, that the contractor has specifically excepted from the operation of the release.

B. The Prompt Payment Act And Its Impact On Prime Contractor And Subcontractor Payments

The Congress passed and the president enacted the federal Prompt Payment Act² in an effort to address the problem of slow payment by the government to its contractors. For construction contracts, the Prompt Payment Act sets up two separate schemes to determine when an agency must make payments of money due to a prime contractor. First, the Act requires that an agency must make payments for work done within 14 days of receipt of a proper invoice.³ Second, for final payments, an agency must make the payment within 30 days of receipt of a proper invoice from the contractor.⁴ Additionally, the FAR prohibits an agency from making a final payment earlier than 7 days before the due date.⁵ This means, in practice, that a contractor can expect that an agency will make final payment sometime between 23 to 30 days from the date the agency receives the invoice.

The Act also govern certain aspects of prime contractor payments to their subcontractors. The Prompt Payment Act requires that certain payment provisions relating to construction contracts be incorporated into the subcontracts entered into by prime contractors. Section 3905(b) of the Act requires prime

¹ Retainage is a portion of the agreed upon contract price deliberately withheld until the work is substantially complete to assure that contractor or subcontractor will satisfy its obligations and complete a construction project.

² 31 U.S.C. §§ 3901 *et seq.*

³ 31 U.S.C. § 3903(6); FAR § 32.904(d)(1)(i).

⁴ 31 U.S.C. § 3903(a)(1)(B); FAR § 52.232-27(a)(1)(ii).

⁵ FAR § 32.906(a).

contractors who are awarded federal contracts to include prompt payment terms in their subcontracts, thereby obligating the general contractor to pay subcontractors within seven days of payment by the government.⁶ The Act also requires prime contractors to direct their subcontractors and suppliers to incorporate similar prompt payment provisions in the agreements with their lower-tier contractors.⁷ These requirements are included in the standard Prompt Payment for Construction Contracts clause.⁸

The Act also allows contractors to include retainage provisions in subcontracts and to withhold payments “in accordance with the subcontract agreement,” where the general contractor notifies the contracting officers of its actions.⁹ Additionally, if the government contractor seeks to withhold funds from a subcontractor for improper work, the contractor is not allowed to request payment for these amounts from the government.¹⁰

To support the goals of the Prompt Payment Act, the Act provides subcontractors with assistance from the government in pursuing prompt payment claims and also provides the subcontractor the information needed to evaluate whether the Act has been violated. Specifically, the contracting officer has the discretion to undertake an investigation into the subcontractor’s allegations. If an investigation is undertaken and it is determined that the prime contractor’s payment certifications are inaccurate, then an administrative or other remedial action must be initiated.¹¹ In addition, the subcontractor may also request that the government furnish information regarding the prime contractor’s payment bond.¹² Last, if a subcontractor believes that it has not been timely paid, it may demand the documentation needed to determine whether payments have been made in accordance with the Act.¹³

C. Special Considerations For Payments To Small Business Subcontractors

In addition to the payment requirements federal prime contractors must follow in regards to all subcontractors, the Executive Branch put forth a host of initiatives in the last several years pushing for accelerated payments to small business subcontractors. In 2012, the Office of Management and Budget put forth policy memorandum M-12-16, requiring federal agencies to provide accelerated payments to small business subcontractors. OMB Memorandum M-13-15 extended this policy by one year. As part of implementation of this OMB policy, the FAR Council put forth a final rule establishing a new clause¹⁴ requiring prime contractors, upon receipt of payment from the government, to make accelerated payments to small business subcontractors, to the maximum extent practicable, after receipt of a proper invoice and all proper documentation from small business subcontractors.

II. **AGC’s Concerns with FAR Council’s Proposed Rule on Small Business Subcontractor Payment**

As noted above, the payment terms of federal government construction contracts already include a host of provisions addressing payments to all subcontractors and special, additional considerations for small

⁶ 31 U.S.C. § 3905(b).

⁷ 31 U.S.C. § 3905(c).

⁸ FAR §§ 52.232-27(c)(1), 52.232-27(c)(3).

⁹ FAR § 52-232-27(d)(3).

¹⁰ FAR § 52.232-27(h).

¹¹ FAR § 32.112-1(c).

¹² FAR § 28.106-6(c).

¹³ FAR § 32.112-2.

¹⁴ FAR § 52.232-40.

business subcontractors. As noted, the Prompt Pay Act already allows a contracting officer to investigate a subcontractor's allegations that it is not being paid; to take remedial action; and to furnish information regarding the prime contractor's payment bond. Additionally, prime contractors are already under an obligation to accelerate payments to small business subcontractors. In combination, these provisions—generally incorporated into the terms and conditions of a subcontract—impose stringent, if not unique, obligations on prime construction contractor related payments to its subcontractors. To the extent that these many requirements to protect small business subcontractor payments are not sufficient, AGC finds the current proposal set forth by the FAR Council a troubling solution as articulated in its concerns that follow.

A. Failure To Define An “Unjustified” Reduced Or Late Payment Will Lead To Contracting Officer And Prime Contractor Confusion

The proposed rule defines the terms “reduced payment” and “untimely payment” as follows:

- “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.
- “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.

Under both of these definitions, the determination of whether a prime contractor payment is either reduced or untimely ultimately hinges upon “the terms and conditions of a subcontract.” The terms and conditions concerning how much and when a subcontractor is paid under a subcontract can vary greatly between such contracts.

AGC is concerned that when a prime contractor self-reports, a contracting officer will find the prime contractor's justification to be “unjustified” for several reasons. First, contracting officers may have training on the provisions of the FAR, but many of them do not have legal training sufficient to interpret the intricacies of a private industry contract between prime and subcontractor. This lack of legal training to determine what prime contractor action is or is not justifiable under the terms and conditions of the subcontract could lead to a prime contractor receiving a negative past performance review for abiding by the legal terms of its subcontract. Second, and to follow up on this later point, by leaving the term “unjustified” undefined, as this proposed rule does, the FAR Council appears to leave significant discretion to a non-lawyer contracting officer as to whether a material breach of a subcontract has occurred. The non-lawyer may interpret “unjustified” to be something meaning “unfair.” When two private industry parties operate in the federal construction marketplace, they negotiate freely. A subcontractor does not have to sign a subcontract. When such a subcontract, however, is executed between the parties, they have each agreed to abide by the terms of those contracts. Whether there is a material breach—a legal term of art—of those contracts is the issue that a contracting officer must determine; not whether there is an unfairly made late or reduced payment.

To help address this issue, assuming that the FAR Council does not withdraw this proposal, AGC recommends that agency counsel, not contracting officers, determine whether a late or reduced payment does not abide by the terms and conditions of a subcontract. In the event that the FAR Council rejects this recommendation, it should define “unjustifiable” late or reduced payments as a material breach of the terms and conditions of the subcontract and provide examples of what would constitute a material

breach of a subcontract under federal case law. Again, AGC is deeply concerned that any justification by a prime contractor for a late or reduced payment will be interpreted under the lens of that contracting officer's opinion of what is fair rather than what is legal under the terms and conditions of the subcontract that prime and subcontractor freely entered into.

Lastly, if the FAR Council chooses not to define the term "unjustifiable," prime contractors will be put in a position of having to report every late or reduced payment to a subcontractor, even if there is no material breach of contract. Prime contractors would, thus, have to self-report even in situations where the subcontractor is actually at fault. Additionally, there are situations where the government changes the scope of a contract, reorganizes, faces budget cuts or other government initiated issues that cause prime contractors to have to either delay or reduce payments to their subcontractors. AGC recommends that the FAR Council note those situations where subcontractors or the government is at fault for late or delayed payment be considered justifiable to avoid contracting officer misinterpretation.

B. Prime Contractors That Comply With The Requirements of This Proposed Rule Are More Likely To Face Penalties Than Prime Contractors That Do Not Comply

This proposed rule requires that prime contractors "self-report" instances when they reduce or delay payments to their subcontractors. Generally speaking, compliant prime contractors—who abide by the law—will follow it. AGC is concerned about bad actors that do not follow this proposed rule and fail to self-report. Arguably, a compliant contractor that self-reports is subjecting itself to the possibility of receiving a negative past performance review. A bad actor contractor that cuts corners and breaks the law may do so here and not self-report. In the event such a bad actor fails to report a late or reduced payment to a subcontractor, AGC fears that there will be no repercussions for its actions. As a result, the compliant contractor will be on an uneven playing field with the bad actor, because the compliant contractor may receive a negative past performance review, while the bad actor receives no negative rating.

With this in mind, AGC seeks clarification from the FAR Council as to what penalties prime contractors could face for failing to self-report these instances? From AGC's perspective, compliant contractors are more likely to pay their subcontractors in full and on time under the terms and conditions of their subcontracts than bad actor contractors, who cut corners. Consequently, AGC has a hard time understanding how this proposed rule will actually seek the intended result of discouraging bad actor prime contractors from unjustifiably failing to pay their subcontractors. AGC respectfully requests that the FAR Council explain how this proposal will encourage bad actors to pay their subcontractors appropriately or discourage them from violating this proposed rule when there appears to be no real penalty for a failure to self-report?

C. Including Additional Requirements For Contracting Officers To Complete On Past Performance Evaluations Will Only Lead To Lesser Quality Evaluations

As it stands, the federal government is focused on ensuring the timely submittal of past performance evaluations into the Past Performance Information Retrieval System (PPIRS). There have been significant efforts through the transition from the Construction Contractor Appraisal Support System (CCASS) to the Contractor Performance Assessment Reporting System (CPARS) to require contracting officers to issue such evaluations at least annually on any given contract and do so on schedule. Contractors are given just 14 calendar days to comment on those evaluations.

When it comes to measuring timely submission by the government of past performance evaluations, measurable metrics exist that allow agencies to measure their success to meet deadlines. However, when it comes to the quality of evaluations, few—if any—metrics exist. For example, a recent Government Accountability Office report detailing the results of the Office of Federal Procurement Policy’s efforts to increase the number and quality of past performance submissions available to source selection officials highlights data on agency completion rates for such evaluations. It’s far more difficult to measure the quality of evaluations submitted by contracting officers and whether those evaluations are actually useful to source selection evaluation board. At this time, AGC is not aware of any measureable statistics governing quality. As a result, agencies focus on meeting time deadlines rather than assuring quality.

Under CPARS, for example, the U.S. Army Corps of Engineers requires contracting officers—referred to as assessing officials in this context—to rate a contractor on seven different categories of performance and issue one of five ratings for each category based on that performance. For any rating, aside from “satisfactory,” the assessing official must provide a narrative on why such a rating was selected for any particular category. As a result, a contracting officer, under pressure to complete past performance evaluations simply issues satisfactory ratings down the line to meet the deadline, which agencies and oversight bodies may review.

Adding an additional requirement to contracting officers’ past performance tasks is unlikely to encourage them to provide detailed information that can actually help a SSEB make a contracting award decision. Like consumers using Yelp, three stars out of five with no substantive or informative reviews written isn’t likely to be all that helpful in determining whether one product is better than another. The FAR Council, GAO, and federal agencies themselves should focus on making these evaluations simpler for contracting officers to complete and in a manner that encourages and even rewards substantive feedback. Adding additional requirements to contracting officers’ past performance plates will not encourage such high quality evaluations the government seeks from its acquisition personnel.

D. The Proposed Rule Does Not Address The Biggest Issue Facing the Federal Construction Industry, Especially Small Businesses: Late Or Reduced Payments from the Government

A general contractor on a construction project is charged with managing subcontractors—whose numbers could range from anywhere from 2 to more than 50—based on a tight and detailed schedule. The general contractor must ensure that it and its subcontractors adhere to the requirements and specifications in the contract with a federal agency. However, sometimes the contract specifications or designs do not meet the practical needs of the project or the federal agency’s project needs may change during construction. Such can happen when a contractor relies on a federal agency’s account of the site conditions and the conditions on the ground are not as stated in the contract—i.e., contractor prepares to build a foundation, but during excavation, finds a previously unknown water well-or when a federal agency decides it needs more or fewer offices for an administrative building.

The problem for many small construction businesses is not that they cannot adjust to meet the changes required to complete the project as the federal agency desires. Rather, the issue is that many federal agencies take months and sometimes a year or more to issue a formal change order notice that a contractor should perform work to address the change—making the agency liable for payment for the work performed. Even after the decision to issue a change order is made, a small business contractor may not actually receive payment for that change order work for a considerable period of time. Because of schedule requirements under the contract, many small business construction contractors perform this change order work without waiting for the formal change order notice from the federal agency. Instead

they may rely upon verbal promises from federal representatives that they will eventually get paid for the work. This is an incredibly risky proposition that, sometimes, leaves the small business unpaid for work it performed at the instruction of a federal representative without official notice. These problems were most recently publicized on the Department of Veterans Affairs' Aurora Hospital project outside Denver, Colorado.

On the VA Aurora Hospital project, the inability of the VA to process contract modifications left the general contractor and its subcontractors without payment for extended periods of time with severe consequences. For example, between September 2011 and September 2012, the VA stopped processing change orders tied to the southern clinic building then under construction.¹⁵ Small companies rely on prompt payments to meet payroll and expenses, often unable to cover those costs for very long.¹⁶ Many rely on bank loans and lines of credit to bridge the gap, but on the Aurora project some banks balked at letting small business clients rely on its money to continue work.¹⁷ According to the Colorado SBA, at least 33 small businesses were not paid for work in a timely fashion, and some were waiting more than a year after work was completed for payment.¹⁸ Of those 33 companies, at least two filed for bankruptcy.¹⁹ The prime contractor even paid subcontractors several million dollars out of its own pockets while waiting for payment from the VA, which was highly unusual.²⁰

While the project in Aurora is a recent and, unfortunately, well-known example, problems with processing change orders happen in every federal construction agency on a regular basis. As such, AGC strongly encourages this the FAR Council to require greater federal agency reporting requirements concerning agency delays with issuing change orders.

E. AGC Seeks Clarification On Lower Tier Small Business Contractors And Application Of This Proposed Rule

As written, AGC believes that this proposed rule only applies to a prime contractor and its first-tier subcontractors. Generally, when the FAR Council intends to apply a rule to subcontractors at any tier, such language is expressly stated by it and in the authorizing statute, which it is not. However, taking an abundance of caution, AGC respectfully requests clarification if this rule applies to subcontractor payment at all tiers? AGC holds that this proposal should by no means require a prime contractor to police its lower tier subcontractors' payments to their subcontractors. Such a requirement would be overly burdensome and impossible to enforce between two separate entities. In the event that this proposal does, in fact, apply to lower tier subcontractors, if a subcontractor makes an untimely or reduced payment to its subcontractor, who is liable: prime contractor or offending subcontractor?

¹⁵ David Migoya & Mark Matthews, *Aurora VA Hospital Project Spooked Subcontractors, Causing Cost Hikes*, DENV. POST, May 15, 2015 available at http://www.denverpost.com/news/ci_28125325/aurora-va-hospital-project-spooked-subcontractors-causing-cost

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ Cathy Proctor, *SBA: Progress being Made on Helping Unpaid VA Hospital Subcontractors*, DENV. BUS. J., April 4, 2013 available at <http://www.bizjournals.com/denver/news/2013/04/04/sba-urges-va-to-speed-payments-for.html>

¹⁹ *Id.*

²⁰ *Id.*

III. Conclusion

Thank you for providing AGC with an opportunity to comment on this important proposal. As previously noted, AGC believes that all contractors—whether paid directly by the government or another contractor—should receive timely and adequate payment for quality work performed. The existing statutory and regulatory requirements governing prime contractor and subcontractor payments already satisfy the intent of this proposed regulation and make the need for such a proposal unnecessary. That stated, in the event that the FAR Council does not withdraw this proposed rule, AGC hopes that it will consider the comments and recommendations set forth in this document.

Sincerely,

/S/

Jimmy Christianson
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The Associated Contractors of America