COUNCIL OF DEFENSE AND SPACE INDUSTRY ASSOCIATIONS
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March 21, 2016

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

Re: CODSIA Comments on FAR Case 2014-004, Payment of Subcontractors; CODSIA Case 3-16

Dear Ms. Flowers:

On behalf of the Council of Defense and Space Industries Associations (CODSIA),[1] we appreciate the opportunity to submit comments on the proposed FAR Case entitled "Payment of Subcontractors" published in the Federal Register on January 20, 2016. The rulemaking is the next Federal Acquisition Regulation (FAR) rule being proposed pursuant to a process beginning with the passage of the Small Business Jobs Act of 2010 (Jobs Act) signed into law on September 27, 2010,[2] whose enactment required the Small Business Administration (SBA) and the FAR Council to coordinate on regulations on many of the contracting provisions in Parts I – IV of Subtitle C of the law.

The proposed FAR rule implements both Section 1334 of the Jobs Act and portions of the SBA rules at 13 CFR 125.3 promulgated pursuant to the underlying statute and finalized in July 2013. The statute amended the Small Business Act (15 U.S.C. 637(d)) to set forth regulatory requirements for the payment of small business subcontractors, and called for regulations from the FAR Council within one year in other related acquisition areas. The FAR Council was not able to meet the statutory deadline for issuing those rules, but now offers this proposed rule.

The 2010 Jobs Act required the FAR Council to define the terms of art related to the acquisition framework, including what constituted a "history of unjustified, untimely payments", and how to process data on those with a "history of unjustified, untimely payments" into the Federal Awardee Performance and Integrity Information System (FAPIIS) for use in the responsibility determination process and for public review.

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[1] At the suggestion of the Department of Defense, the Council of Defense and Space Industry Associations (CODSIA) was formed in 1964 by industry associations with common interests in federal procurement policy issues, at the suggestion of the Department of Defense. CODSIA consists of six associations – the Aerospace Industries Association, the American Council of Engineering Companies, the Information Technology Alliance for Public Sector, the National Defense Industrial Association, the Professional Services Council, and the U.S. Chamber of Commerce. CODSIA acts as an institutional focal point for coordination of its members' positions regarding policies, regulations, directives, and procedures that affect them. Combined these associations represent thousands of government contractors and subcontractors. A decision by any member association to abstain from participation in a particular case is not necessarily an indication of dissent.

[2] P.L. 111-240

Introduction

CODSIA commented in January of 2012 on the SBA implementation of Section 1334 and other Jobs Act provisions.[3] Among other things, the comments highlighted the need to create a more meaningful and proportional standard for the term "history of unjustified, untimely payments" and to reject "three" as the number of late or reduced payments on a single contract over a 12 month period as the proposed SBA regulatory requirement, given that that statute did not require such an exacting test for implementation and that such a number was random, impractical to implement and not scalable for large contractors.

CODSIA also recommended that SBA convene a group of large and small businesses to specifically identify alternatives to defining a specific percentage or number of late or reduced payments in any rules and to further identify the scope of the problem since the data available at the time did not support the general assertion that large prime contractors were in the practice of unjustifiably withholding payments from their suppliers, large or small.

The SBA promulgated their final rules at 13 CFR 125.3 implementing Section 1334 in July 2013 by mostly adopting the statutory language set forth in the Jobs Act amending 15 U.S.C. 637(d)(12), but also including the standard of three late or reduced payments as the benchmark for industry for "history of unjustified untimely or reduced payments". It is unclear from the preamble to the SBA rules why three was chosen or that the SBA responded to industry concerns about the standard of three occasions, but the SBA apparently ignored industry comments in this area and adopted their regulations as proposed. This rule, unfortunately, pursues the same regulatory path in defining certain acquisition terms that the SBA took in 2013.

In hindsight, while the underlying statute contained many positive changes to the existing acquisition and governance structures related to the prime and small business subcontractor relationship, the length of time taken to promulgate the SBA rules and now the FAR rules presents difficult policy challenges for those dedicated to a balanced acquisition framework. This is especially true where many in the private sector requested changes to the original SBA rules, had no further opportunity to engage in any serious policy discussion over the ensuing years and the SBA rules then became incorporated into the acquisition system by sheer dint of lapsed time. Nonetheless, we offer the following comments and hope that industry comments can persuade the FAR Council to be flexible and practical in interpreting the statutory intent in areas where we believe the SBA was overly prescriptive.

Comments

The proposed FAR rule creates a series of contract obligations for large prime contractors and Contracting Officers (CO), where Small Business Subcontracting Plans are required under FAR 52.219-9, Small Business Subcontracting Plan. Most notable of these is to provide notice and explanation to the CO when a large prime contractor makes a reduced or late payment (terms discussed herein) to a small business subcontractor and for the CO to evaluate any explanation and make a determination whether the prime contractor's payment is unjustified in any given instance and/or signifies a "history of unjustified untimely or reduced payments." If the CO determines that there is a history of unjustified payments, the CO must report their

[3] CODSIA letter dated 1-6-2012, Small Business Subcontracting Proposed Rule – RIN 3245-AG22 CODSIA Case 01-12

findings/determination to FAPIIS for purposes of supporting future responsibility determinations of the prime contractor.

Determinations of applicability to the acquisition of commercial and Commercial Off-the-Shelf (COTS) Items

The FAR proposed rule reflects a regulatory "best interests" analysis of the rule pursuant to both the 41 USC 1906 and 1907 requirement to not apply unique government rules to the acquisition of commercial or COTS items where the statute does not specifically require it. While commendable and notable for its attempt to explain the rule's rationale and to address frequent industry criticism that such analysis are overly simplistic and unsupported by accurate data, the justification that the proposed rule furthers the interest in existing small business subcontracting policies and conforms with the operative clauses at 52.219-9 and 52.232-40 (Accelerated Payment) is misleading. Ultimately, we believe that the rationale is flawed and the burdens severely understated for both commercial and COTS item providers.

While the administration has promoted an accelerated payment policy to small businesses as prime and subcontractors, the policy application has been spotty and it is not universally true that federal agencies acquiring supplies and services are accelerating such payments. Despite that, many large contractors continue to voluntarily provide prompt payment to their small business suppliers and subcontractors as a sound business practice and to observe the tenets of the OMB and FAR accelerated payments clause of their own accord, even where the government does not make accelerated payments to those contractors first, which is the policy predicate for large contractors accelerating payments to their small business subcontractors.

For many other large prime contractors, the lack of the predicate prime contract payment and/or lack of cash flow controls over their desire to build partnerships within their small business suppliers and many simply cannot afford to make payments within the 15 day payment goal. That does not indicate that the large prime is in violation of the policy or a bad actor.

The FAR Council analysis on contractor burdens also posits that the reporting or notice requirements required under the new clauses are insignificant. That might arguably be true if, among other things, the definition of "history of unjustified payments" were not limited to the current definition of three instances, but as currently structured, large prime contractors may be inadvertently faced with notice and explanation duties on hundreds or thousands of contracts with Small Business Subcontracting plan requirements involving payments.

The analysis ignores the possibility that even the most diligent prime contractor may inevitably run afoul of this rule's requirements where circumstances create conditions that could be perceived as "unjustified" where, even if not, an explanation and adjudicative process is required by the large prime contractors. These administrative and adjudicative processes are costly to erect and manage for all contractors. It is also not inconceivable that small businesses deep within a vendor's supply chain could assert to a CO that it had not been paid timely by the next higher tiered contractor in the supply chain and that act alone could trigger the reporting duty and requisite investigation required by a large prime to explain to a CO why non-payment to that small business subcontractor somewhere in the supply chain was justified or within the terms of the contract.

There are a number of reasons that would cause a prime to legitimately "short-pay" an invoice. These could include: FATCA/other withholds, incorrect taxes charged, incorrect freight charged, short pays within $0.50 command media tolerance, etc. Is the guidance that all of those situations would have to be reportable? Additionally, there can be disagreement with vendors on what is meant by 90 days past due. Vendors usually start the clock when they send the invoice. However, we frequently are asked why we are delinquent paying invoices, only to find out we never received it – it was either sent to the wrong address, or was a duplicate invoice, among other situations. Clearly, we cannot consider payment terms to have started if we've never received an invoice to pay. Does the FAR guidance stipulate when the 90 days would start?

Additionally, it is equally important to take into consideration the reason that a small business supplier invoice is past due. For example, if it's as a result of something that needs to be resolved by the supplier, then companies should not be held liable if they have actively tried to resolve the issues with the supplier but they have not been able to close on resolution of the issue. Having said that, it is expected these instances would be rare.

CODSIA recommends that the FAR Council reconsider the application of this rule to commercial and COTS item providers as not being in the best interests of the government and contrary to ongoing attempts by government policy makers to streamline the acquisition process for the acquisition of commercial and COTS items to reduce the number of unique government rules applicable to large and small businesses providing commercial and COTS supplies and services, and to introduce more commercial innovation and technology into the federal business market.

It also appears that the analysis in II.A and B cite $650,000 and $700,000 variously as the operative Small Business Subcontracting Plan threshold; while a minor point, and not pertinent to the rule's operation itself, the FAR Council should be consistent when attempting to persuade the public that the analysis performed is administratively valid and take steps to conform to the cited thresholds.

<u>Policy and Clause language</u>

1. Meaning of "terms and conditions" of a subcontract:

The basic underpinning of the rule is that "unjustified reduced or untimely payments" to small business Subcontractors are inconsistent with federal policy and violate contract law, but only where the small business subcontractor conclusively fulfills their obligations under the "terms and conditions" of the subcontract. The proposed rule fails to emphasize that any payment obligations from the prime to the small business subcontractor are contingent on whether, it its totality, the subcontractor completes all the obligations of the subcontract before any self-reporting that payment is late or reduced is required to be made by the prime contractor. It is reasonable to conclude, and a huge understatement, that opinions of the parties to a subcontract will vary widely about whether the subcontract is complete in any given situation.

Given the potential negative impact to present responsibility that this rule could produce, the rule should thus strongly emphasize that "terms and conditions of a subcontract" can mean a broad range of interpretations across many different industry sectors about what it means for a party to fully complete its contractual obligations. This is especially where federal contracts are financed by periodic payments by the government, and where many offsetting federal contract provisions, such as inspection and acceptance, strict invoicing

requirements, or failure to perform, automatically govern whether contract payment should be made and/or complies with the contract.

CODSIA recommends that the phrase "terms and conditions" be expanded for the purposes of this rule. It should cover all contract performance obligations including, but not limited to, any predicate conditions to payment determined and agreed to at the outset by the parties, including where federal subcontract flow-downs or unique industry clauses are used, and including any rights and remedies reserved to, or given up by, the parties under the subcontract, as well as those terms and conditions established through a course of prior dealings between the parties or otherwise established under contract law or unique to a specific industry sector.

In addition, CO's need substantially more guidance about how to evaluate competing factual assertions by parties given in notices or reports about what is a reduced or late payment and why. The government should consider issuing a standard format for the notice required under FAR 52.242-XX(c) to alleviate inconsistent demands across federal agencies for differing levels of detailed information pursuant to any notice and to reduce assertions by CO's that the large prime contractor or small business subcontractor have not provided the necessary exculpatory or underlying data to support any claims of payment or non-payment during the adjudication process. This standard format would be part of a defined process established by the government, detailing not only the documentation the COs would request, but also the parameters under which other COs could use the information when evaluating a prime contractors' past performance for future procurements. Without such parameters, given the varying levels of experience and knowledge among COs, some COs could conceivably draw incorrect conclusions about a contractor's solvency or make an erroneous responsibility determination using the information.

All contractors will bear increased risk where COs have little guidance and are not trained about how to interpret the "terms and conditions" of a subcontract, especially where the subcontract does not mirror a federal contract. One unintended consequence of this proposed rule is that the CO may now become the recipient of, and repository for, all subcontracts between large and small business for prime contracts that require a small business subcontracting plan because of the need to adjudicate competing explanations of non-payment before posting past performance data to FAPIIS. COs will thus become the de facto arbiters of contract relationships between large prime and small business subcontractors, rather than the parties themselves.

The 2010 Jobs Act clearly did not contemplate creating a managerial role for federal CO's to insert themselves into a subcontract relationship or become embroiled in potential litigation every time a decision surrounding the reason why a payment is reduced or untimely is reported favorably for one party or another. This rule increases the risk that prime and subcontractors will cede their rights to a third party CO to decide whether a subcontract has been fully performed.

2. Scalability and Proportionality

As set forth in the introduction, CODSIA previously recommended that SBA, and now the FAR Council, reconsider that three occasions on a single contract in 12 months qualifies as a "history of unjustified reduced or untimely payments."

In our comments on the SBA proposed rule, CODSIA recommended a rolling scale based on a number of subcontract payments made each year or number of prime contracts so that a company making 10,000 small business subcontract payments each year was not measured the same way as one making 100 payments. As stated above, there was no explanation in the SBA rules for why three occasions was selected by the SBA or that the Jobs Act required such a draconian approach to subcontract enforcement. There are potentially an endless number of ways that the government could create a framework to balance large and small contractors' rights proportional to the number of payments involved across the universe of small business subcontracts, but the SBA rejected any further engagement with industry at the time the SBA rules were finalized.

It is also not inconceivable that large contractors will interpret the reporting standard very liberally and that small business subcontractors will interpret the CO obligation very conservatively, and the rule result in either no reporting or over-reporting and litigation over the facts and past performance data in FAPIIS. To incentivize self-reporting, and to prevent creating an overly litigious approach to small business subcontracting by the parties to a federal contract requiring a small business subcontracting plan, the FAR Council must delete the standard of three occasions of non-payment as the criteria for a "history of unjustified untimely or reduced payments" and attempt to erect a proportionality standard in its place.

Industry is ready to assist in that discussion, but a standard of three will fail to achieve the objectives of the 2010 Jobs Act to reduce the number of "unjustified, untimely payments" to small business subcontractors and will create an additional non-value added federal administrative bureaucracy, lead to unnecessary litigation over unjustified poor past performance ratings, and dis-incentivize large commercial and COTS items providers from entering into the federal market.

3. Role of the Contracting Officer

Under the proposed rule, the Contracting Officer is given the sole discretion to determine whether a late or reduced payment was unjustified. Moreover, the information that is self-reported by the contractor is used for past performance evaluations. Given the varying levels of experience and knowledge among contracting officers and the potential risk to contractors, the Government needs to:

(a) Clarify "boundaries" by having a defined process for a contracting officer's determination using this information and clear guidance on how to use the information that is self-reported by contractors. There is concern that a Contracting Officer may use this information to draw incorrect conclusions about a contractor's solvency or make a responsibility determination; and

(b) Specify what the contracting officer would use to determine that a reduced or untimely payment was unjustified. For example, would the contracting officer only consider the contractor's self-reported late or reduced payments and its corresponding explanation, or would the contracting officer request a statement from the subcontractor? Would the contracting officer request a copy of the subcontract in order to review and interpret the payment terms?

Conclusion

We appreciate the opportunity to submit comments about this proposed rule. Should you require any additional information from us on this topic, please contact Erica R. McCann at emccann@itic.org, who serves as our project officer for this case.

Respectfully submitted,

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