

## **NEW RULES DESIGNED TO PROTECT SUBCONTRACTORS FROM PRIMES WHO DO NOT FULLY OR TIMELY PAY INVOICES**

On September 27, 2010, President Obama signed into law the Small Business Jobs and Credit Act of 2010 (SBJCA), which created a new rule which will hopefully provide some needed relief for those subcontractors who only receive partial or untimely payments from their less than reliable prime contractor teaming partners. As discussed below, the SBJCA appears to require contacting officers to expose and downgrade prime contractors who fail to fully or timely pay their subcontractors.

Subcontractors have in the past griped that the federal government may have sounded sympathetic, but, in practice, rarely did much to protect subcontractors from prime contractors who were not making timely payments, preferring to stay uninvolved in such “disputes”. Because subcontractors are not in “privity” of contract with the federal government customer, they cannot seek reimbursement for unpaid invoices directly from the customer. Instead, with rare exceptions, they are left to seek recovery from the prime contractor who may be unwilling and/or unable to make payment. A subcontractor takes a severe risk when it works with a prime contractor who has a record of being delinquent in paying invoices or who is financially distressed.

Although under the present version of FAR 32.112-1 (Subcontractor assertions of nonpayment), subcontractors can assert instances of nonpayment to a contracting officer, that provision does not compel the government to take any specific action in response to such assertions. The contracting officer has the discretion to determine if the subcontractor has not been paid in accordance with the subcontract and may in appropriate circumstances: (i) encourage the prime to make timely payments to the subcontractor, and/or, (ii) reduce or suspend progress payments to the prime. In extreme cases, the contracting officer may also refer cases to criminal authorities, if the contracting officer suspects that the prime has falsely asserted that it has made timely payment to its subcontractor. However, in our experience, the government can also simply decline to get involved in payment disputes between prime contractors and subcontractors. After all, one of the reasons the government hires prime contractors is to avoid having to deal directly with disputes involving subcontractors. To further complicate a subcontractor’s predicament, some prime contracts contain clauses which prohibit the subcontractor from communicating directly with the government.

Now, Section 1334 of the SBJCA is crafted to provide protection to subcontractors by significantly raising the stakes for those prime contractors who do not act responsibly with respect to paying their subcontractors on time. Specifically, each prime contractor with a subcontracting plan (which are generally required for procurements in excess of \$650,000.00) must now notify the contracting officer in writing, i.e., *report itself to its customer*, whenever the prime contractor pays a reduced price to a subcontractor for goods and services or pays the subcontractor more than 90 days late. In providing this notice, the prime contractor must advise the contracting officer of the reason for the reduced or delayed payment. Then, according to the new law, if the contracting officer determines that the contractor’s reduced or delayed payment is “unjustified”, the contracting officer is required to 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.

Thus, a prime contractor who fails to fully pay or delays in paying its subcontractors should, at least, theoretically, be on the receiving end of a negative past performance evaluation. Section 1334 also directs that the government develop a process for contracting officers to record the identity of prime contractors with a history of unjustified, untimely payments to subcontractors, and include this information into the Federal Awardee Performance and Integrity Information System (FAPIS). If this new rule works effectively, unscrupulous prime contractors who fail to pay their subcontractors will have a harder time competing for future jobs, and subcontractors should also have a new tool for researching the integrity of prospective teaming partners.

The legislation does not define what constitutes “unjustified” untimely payments and leaves that issue to the promulgation of implementing regulations which are due later this year. Also, the new law doesn’t explain exactly what is supposed to happen if the prime contractor fails to report its untimely payments. Presumably failure to do so should constitute a default in performance of the prime contract, but we will have to await the implementing regulations to determine exactly how the failure to timely report could affect the performance of ongoing prime contracts and how aggressive the government will be in enforcing the new provisions. Hopefully, at a minimum, the new rule will cause unscrupulous prime contractor to think twice before delaying or failing to make payments to subcontractors.

### **SUMMARY**

If you need any additional information concerning the matters addressed in this Client Alert or other issues relating to government contracting, you can contact **Ken Brody of David, Brody & Dondershine, LLP at 703-264-2220 or [KBrody@dbd-law.com](mailto:KBrody@dbd-law.com)**. Additional information concerning David, Brody & Dondershine, LLP can be found at [www.dbd-law.com](http://www.dbd-law.com).

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