

# Hot Topics in Federal Government Contract

# COMPLIANCE

**Here's what surety professionals and their contractors should know.**

LEGAL

RULES

This is the first in a series of five articles on federal government contract compliance requirements that contractors often fail to satisfy.



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**WHEN IT COMES** to federal government contracting, compliance can be the last item that construction contractors want to address. It can be burdensome and time-consuming, and every dollar amount that a contractor devotes to compliance cuts into a contractor's bottom line. Despite the arduous nature of compliance, however, the risks and consequences of not complying with contractual require-

ments far outweigh the burdens encountered and the costs of compliance. These risks, consequences, and costs are particularly outweighed when compared to the relatively straightforward compliance requirements that contractors often fail to satisfy.

Set forth below is a discussion of the potential consequences of compliance failures, a summary of two selected compliance areas that have recently been the focus of the federal government's compliance enforcement efforts,

and conclusions for surety professionals and their construction contractors.

## **A. Severe consequences for compliance failures**

Federal government contractors' failures to comply with various contract requirements are not taken lightly by the government. Draconian penalties are commonplace, and even a single violation can be catastrophic for contractors with a government contracting portfolio. These draconian penalties are frequently levied through the government's assertion of claims against contractors, termination for default of contractors' contracts, suspension and debarment of contractors, and False Claims Act suits against contractors.

At the very least, and similar to concepts in the commercial sector, contractors' failure to comply with contractual requirements can result in litigation and the government's termination for default of contracts. With respect to litigation, non-compliance with a contract requirement may have a financial impact on the government; and, particularly in light of recent budget limitations, the government can seek to mitigate that financial impact by asserting claims against the contractor. In connection with terminations for default, even a seemingly minor failure to comply can result in a termination; and recent budget woes within the federal government have incentivized the government to terminate contracts and increased the number of

terminations against contractors. Even more significant, government claims and terminations for default can (and likely will) lead to more serious penalties, such as suspension and debarment and civil False Claims suits.

Moving up the scale in the list of penalties, compliance failures can also result in suspension and debarment, the effect of which is tantamount to the “blacklisting” of contractors from federal awards. Given federal government contracting agencies’ unique position as guardians of the federal treasury, the government strives to only contract with business entities that are responsible contractors; and the government will suspend and debar any contractor it deems to be irresponsible. A contractor’s lack of responsibility can be determined in a number of ways, but a contractor’s intentional breach of a contractual compliance requirement or even a pattern of noncompliance can result in a finding of a lack of responsibility and then suspension and debarment.

Finally, and perhaps the most serious of all consequences, failures to comply with contractual requirements can result in False Claims Act suits, which can result in staggering monetary penalties against contractors. Although false claims can arise under many different circumstances, relevant to the compliance discussion, false claims can arise under the implied certification doctrine, which generally holds that a contractor’s failure to comply with a contract requirement makes any invoice submitted by the contractor for work performed under the contract false. And under the False Claims Act, a contractor may be assessed a penalty in the form of treble damages—a penalty equal to three times the amount of the falsified invoice. Therefore, the False Claims Act, particularly in recent years with the adoption of the implied certification doctrine, is tailored to enforcing contractors’ compliance; and recent False Claims Act litigation demonstrates that compliance remains a focus in federal enforcement efforts.

Accordingly, given the severe consequences that can result from a failure to comply with a contractual requirement, compliance must be at the forefront of any construction company’s business.

## **B. The Davis-Bacon Act and the FAR’s limitations on subcontracting**

Surety professionals and their contractors should pay particular attention to two specific compliance areas. Compliance requirements imposed by the Davis-Bacon Act and contractual requirements imposed through the Federal Acquisition Regulation’s (FAR’s) limitations on subcontracting are particularly relevant, given the government’s recent focus on these compliance areas. Fortunately, compliance in these areas is relatively straightforward as long as contractors invest at least a modicum of effort into understanding the requirements. Set forth below are short summaries of these two important compliance areas.

### **1. The Davis-Bacon Act’s compliance requirements**

The Davis-Bacon Act presents a unique compliance challenge for contractors participating in public works projects. The Davis-Bacon Act arises under a 1931 law requiring federal contractors to compensate certain “laborers” and “mechanics” specified rates for labor performed on public works. These rates are set by the U.S. Department of Labor and vary according to the employee’s labor classification and the geographic area where work is performed. In addition to regulating wage rates, the Davis-Bacon Act imposes significant recordkeeping requirements and requires employers to submit detailed certified payrolls on a weekly basis.

Notably, the Davis-Bacon Act only applies to laborers and mechanics employed at the “site of the work” or travelling between “sites of the work.” Even if the work in question is not being performed at the physical location called for in the contract, the “site of the work” may include headquarters, tool yards, batch plants, and other locations, if the work at these locations is dedicated exclusively to the project and the locations are adjacent to the site of the work. The “site of the work” does not include home offices, fabrication plants, tool yards, or other sites where the location and its continued operation are determined without regard to the project. While these distinctions can seem byzantine, the distinctions are important because employees who are employed at the “site of the work” are entitled to Davis-Bacon Act wages; and contractors can quickly run afoul of the Davis-Bacon Act if they improperly define the “site of the work” in connection with a Davis-Bacon Act covered project.

In short, the Davis-Bacon Act’s requirements can be burdensome and intricate, but it is important that contractors familiarize themselves with the Act’s requirements and seek guidance when questions arise in contract performance. Recent enforcement actions, in the form of False Claims Act suits, have focused on contractors’ failure to compensate their employees the proper amounts due under the Davis-Bacon Act; and contractors are well-advised to devote particular attention to this increasingly targeted compliance area.

### **2. Subcontracting limitation compliance requirements**

Most federal government contracts include FAR clauses that restrict how and to whom a prime contractor can subcontract work. Collectively, these clauses are referred to as “subcontracting limitations”; and these limitations come in numerous different forms with which contractors are required to comply, particularly in the areas of subcontract notification and subcontract performance limitations.

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producers and underwriters must confirm what bond is required by the court and what liability the surety may ultimately face. A careful review of what bond is necessary will not only ensure that the correct type of bond is issued, but also it will enable the producer to secure the correct amount of collateral.

Finally, producers and underwriters should check the requirements of the relevant jurisdiction, to make sure that any specific local rules or requirements are taken

into account when deciding on a bond form. ●

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Subcontract notification clauses require the prime contractor to provide notification to the government prior to the prime contractor entering into a subcontract. The most prevalent subcontract notification clause in federal government contracts, FAR 52.244-2, Consent to Subcontract, is typically included in cost-type contracts and requires the prime contractor to not only notify the government of a potential subcontract award, but also to obtain the government's consent prior to the prime entering into the subcontract. A related subcontract notification clause, FAR 52.244-5, Competition in Subcontracting, requires the prime contractor to notify the government reasonably in advance of placing a subcontract and also generally requires the prime contractor to select the subcontractor on a competitive basis.

Subcontract performance clauses limit the prime contractor's ability to subcontract out certain portions of the work called for under the prime contract. In this area, the most prevalent clause, FAR 52.219-4, Limitations on Subcontracting, is included in most small business set-aside contracts. The clause operates to prevent large business contractors from circumventing the

requirements of the set-aside programs. Under this clause, when a small business contractor receives a set-aside award, it is required to perform a certain percentage of the work itself; and the contractor is prohibited from subcontracting out work in excess of that percentage. The percentage of work that must be performed by the small business varies from contract to contract, with the small business being required to perform only 15 percent of the work under a general construction contract and generally 50 percent of the work under a services or supply contract.

In sum, the subcontracting limitations placed on subcontractors are numerous, but compliance with these clauses is relatively straightforward. Notwithstanding the relatively straightforward requirements, recent enforcement actions in this area, also in the form of False Claims Act suits, demonstrate that certain contractors have repeatedly failed to understand and follow the subcontracting limitations in their contracts. Again, to the extent questions arise as to how to comply with subcontracting limitations, contractors are well-advised to seek guidance in this increasingly targeted compliance area.

As addressed above, the consequences for compliance failures can be severe. Government claims, termination for default, suspension and debarment, and False Claims Act suits are all mechanisms that can be brought to bear against a contractor, with any one of these mechanisms capable of serving a crippling blow to a contractor's business. However, while compliance can be burdensome, the burden associated with compliance is far outweighed by the potentially devastating result that can flow from a contractor's compliance failure. And the key to compliance is an understanding of each contract's requirements. While the compliance burden on federal construction contractors may seem daunting, a thorough understanding of the government's compliance requirements and maintaining an effective system to stay informed of those requirements makes federal contracting a manageable and lucrative endeavor. ●

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Be sure to read Avery's next article on Evolving Compliance Requirements: the New Anti-Human Trafficking Requirements.