Legal Protections for Subcontractors on Federal Prime Contracts

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Summary

Payment and other protections for subcontractors on certain federal contracts under the Miller Act, the Prompt Payment Act, and the Small Business Act have recently become a topic of congressional and public interest because of the effects of the recession upon small businesses. Many subcontractors on federal prime contracts are small businesses, and small businesses generally receive special consideration under federal law and policy.

The Miller Act of 1935 authorizes subcontractors who furnished labor or materials used in carrying out federal construction projects valued in excess of $150,000 to bring a civil action against prime contractors’ payment bonds to obtain payments due. Congress enacted the Miller Act to compensate for the difficulties that subcontractors would otherwise have in obtaining payment from federal construction contractors, given that they cannot place a mechanic’s lien on the work because the government has sovereign immunity. The doctrine of sovereign immunity protects the government from being sued without its consent, and the Contract Disputes Act waives the government’s sovereign immunity only as to suits involving contracts to which it is a party, not subcontracts under these contracts. Relatedly, there is no privity of contract, or direct contractual relationship, between the government and the subcontractor, which means that the subcontractor cannot sue to enforce the payment or other terms of the subcontract against the government.

The 1988 amendments to the Prompt Payment Act provide an additional form of payment protection for subcontractors on federal construction contracts by requiring federal agencies to include in their contracts a clause obligating the prime contractor to pay the subcontractor for “satisfactory” performance within seven days of receiving payment from the government. Absent such a clause in the prime contract, the prime contractor would generally be free to agree to whatever payment terms it wishes with the subcontractor and would not necessarily pay the subcontractor as quickly.

The Small Business Act provides a different sort of protection for some prospective subcontractors by requiring that prime contractors agree to plans for subcontracting some percentage of the work to be performed under certain federal contracts with various types of small businesses (e.g., women-owned small businesses, service-disabled veteran-owned small businesses). Without such subcontracting plans, or similar contract terms, prime contractors would be free to subcontract with whomever they wish for the completion of work under the contract and would not be required to deal with these categories of small businesses.

Members of the 111th Congress have introduced legislation that would augment these protections by (1) requiring contractors with subcontracting plans to notify the Small Business Administration (SBA) whenever they pay a reduced price to a subcontractor (S. 2989); (2) requiring that contractors work with the subcontractors whom they identified in any subcontracting plans submitted with their bids or offers (H.R. 4134); (3) requiring withholding of contract payments from contractors who do not achieve their goals for subcontracting with small businesses owned and controlled by socially and economically disadvantaged individuals (H.R. 4929); (4) requiring SBA to promulgate regulations to govern its review of subcontracting plans, including standards for determining contractors’ “good faith compliance” with such plans (H.R. 5109); and (5) requiring that the Department of Defense periodically assess the performance of the defense acquisition system, including contractors’ performance in subcontracting (H.R. 5136).
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Introduction

This report provides an overview of the payment and other protections for subcontractors on certain federal prime contracts under the Miller Act, the 1988 amendments to the Prompt Payment Act, and the Small Business Act. Congress enacted these statutes to give subcontractors rights and remedies they would not otherwise have because of legal doctrines relating to sovereign immunity, privity of contract, and freedom to contract. Such protections have recently become a topic of congressional and public interest because of the effects of the recession upon small businesses. Many subcontractors on federal prime contracts are small businesses, and small businesses generally receive special consideration under federal law and policy.

The report also discusses legislation introduced in the 111th Congress that would provide additional protections for subcontractors (e.g., H.R. 4134, H.R. 4929, H.R. 5109, H.R. 5136, S. 2989). It does not discuss protections for subcontractors’ employees provided under other provisions of law.

The Miller Act

A Depression-era enactment named after its sponsor, Representative John Elvis Miller of Arkansas, the Miller Act creates a federal remedy for subcontractors who “furnish[] labor or material in carrying out work provided for” in certain federal construction contracts. Absent the Miller Act, such subcontractors would generally have to rely on breach of contract actions against the prime contractor under state law to recover payments due to them because of the operation of the legal doctrines of privity of contract and sovereign immunity. Although working pursuant to a subcontract under a federal contract, subcontractors generally cannot enforce the payment or other terms of the contract or subcontract against the federal government because there is no privity of contract, or direct contractual relationship, between the subcontractor and the

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2 See, for example, Are Government Purchasing Policies Failing Small Businesses? A Roundtable before the Committee on Small Business and Entrepreneurship, 107th Cong., 2d Sess., at 38 (June 19, 2002) (“A lot of prime contractors today, small businesses start off as subcontractors.”).

3 See, for example, The Small Business Act of 1958, P.L. 85-536, § 2(a), 72 Stat. 384 (July 18, 1958) (codified at 15 U.S.C. § 631(a)) (“[I]t is the declared policy of the Congress that the Government should aid, counsel, assist, and protect, insofar as is possible, the interests of small-business concerns.”).

4 See, for example, 40 U.S.C. § 3145(a) (requiring that employees of subcontractors on certain federal construction contracts be paid prevailing wages); Executive Order 13495, 74 Fed. Reg. 6103 (Feb. 4, 2009) (giving employees of subcontractors of the incumbent contractor the right of first refusal to non-management and non-supervisory positions when a new contractor takes over performance of the contract); 48 C.F.R. § 22.802(a)(2) (affirmative action requirements for subcontractors); 48 C.F.R. Subpart 22.14 (definitions for subcontractor employees with disabilities); 48 C.F.R. § 3.907 (protection for subcontractor employees who are whistleblowers).

government. The subcontractor’s contract is with the prime contractor, as is the government’s contract; there is no contract between the subcontractor and the government. Additionally, because the government has sovereign immunity and cannot be sued without its consent, the subcontractor cannot place a mechanic’s lien on the improved property, as it could with a private construction project.

The Miller Act requires that, before any contract of more than $150,000 is awarded for the construction, alteration, or repair of a “public building or public work of the Federal government,” the contractor furnish two bonds to the government. The first of these is a performance or completion bond, which would compensate the government for any defects in the contractor’s performance under the contract. The second is a payment bond, which would assure that certain persons who supply labor or materials used in carrying out the work provided for in the contract receive payment. Both bonds become legally binding upon award of the contract, and their “penal amounts,” or the maximum amounts of the surety’s obligation, must generally be 100% of the original contract price plus 100% of any price increases.

The act further authorizes “[e]very person that … furnished labor or material” in carrying out work provided for in the contract who was not paid in full within 90 days of completing performance to bring a civil action on the payment bond for the amount due. However, “[e]very person,” as used here, includes only first- and second-tier subcontractors. Lower-tier subcontractors are excluded, as are “materialmen” or other parties who supply materials or labor without a contract. These exclusions are partly based on policy considerations and partly based on the definition of “subcontractor.” Prime contractors would have greater difficulties in

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6 See, for example, Williams v. Fenix & Scisson, 608 F.2d 1205 (9th Cir. 1979) (finding that the defendant owed no contractual duty to the plaintiff because the defendant’s contract was with the plaintiff’s employer, not the plaintiff). Under narrow circumstances, persons who are not parties to a contract but are “third party beneficiaries” to it are entitled to enforce the contract’s terms. However, this is generally only the case when the purpose of the contract is to confer a gift on the third party, or when the purpose of one party to the contract is to discharge an actual, supposed, or asserted duty to the third party. See, for example, Young Ref. v. Pennzoil, 46 S.W.3d 380 (Tex. App. 2001). Subcontractors under federal prime contracts would generally not qualify as third-party beneficiaries entitled to enforce the terms of the prime contract under either of these tests.

7 The Contract Disputes Act waives the government’s sovereign immunity concerning claims arising under or relating to its contracts, but not for claims arising under or relating to subcontractors under its contracts. See 41 U.S.C. §§ 601-613.

8 See, for example, F.D. Rich Co. v. United States for Use of Indust. Lumber Co., 417 U.S. 116, 122 (1974) (“Ordinarily, a supplier of labor or materials on a private construction project can secure a mechanic’s lien against the improved property under state law. But a lien cannot attach to Government property, … so suppliers on Government projects are deprived of their usual security interest. The Miller Act was intended to provide an alternative remedy to protect the rights of these suppliers.”).

9 A bond is a promise by a surety, or third party, to pay any debts of the contractor or make good any default by or failure of the contractor to satisfy a contractual obligation. See Taylor Constr. Inc. v. ABT Serv. Corp., Inc., 163 F.3d 1119 (9th Cir. 1998).


11 Performance bonds may be less than 100% provided that the contracting officer determines that a smaller amount will adequately protect the government. 40 U.S.C. § 3133(b)(2).


13 40 U.S.C. § 3133(b)(2) (authorizing suits by “person[s] having a direct contractual relationship with a subcontractor but no contractual relationship, express or implied, with the contractor furnishing the payment bond”).

14 See, for example, Clifford F. MacEvoy Co. v. United States, 322 U.S. 102, 108-09 (1944) (finding that “those who merely sold materials to materialmen, who in turn sold them to the prime contractor,” are not entitled to recover on Miller Act payment bonds).
protecting themselves from liability to remote tiers of subcontractors or materialmen than they would in protecting themselves from liability to first- or second-tier subcontractors.\textsuperscript{15} Materialmen are further excluded because the usage of “subcontractor” in the building trades includes only “one who performs for or takes from the prime contractor a specific part of the labor or material requirements of the original contract.”\textsuperscript{16} The term “thus exclude[s] ordinary laborers and materialmen.”\textsuperscript{17}

First- and second-tier subcontractors seeking payment on a Miller Act bond must file suit in the name of the United States within one year of completing performance in the federal district court for the area where the subcontractor provided labor or services under the contract.\textsuperscript{18} They must also provide the prime contractor with notice served in the same manner as a summons or by any other means that provides written, third-party verification of delivery to the contractor at its place of business or primary residence.\textsuperscript{19} Failure to provide proper notice may bar recovery from either the prime contractor or the surety.\textsuperscript{20} Assuming proper notice, the amount a subcontractor may recover if it prevails in the litigation is generally based on the contract amount for the goods or services or, if no amount is specified in the contract, the amount that a person in the subcontractor’s position at the time and place the services were rendered would have spent completing those services.\textsuperscript{21} However, after performance is completed, subcontractors may waive in writing their right to bring a civil action, in which case no recovery may be made on the bond.\textsuperscript{22}

Contractors that fail to obtain performance bonds as required under the Miller Act are in breach of their contract with the government and could potentially be terminated for default by the

\textsuperscript{15} Id. at 110 (internal citations omitted) (“The relatively few subcontractors who perform part of the original contract represent in a sense the prime contractor and are well known to him. It is easy for the prime contractor to secure himself against loss by requiring the subcontractors to give security by bond, or otherwise, for the payment of those who contract directly with the subcontractors. But this method of protection is generally inadequate to cope with remote and undeterminable liabilities incurred by an ordinary materialman, who may be a manufacturer, a wholesaler or a retailer. Many such materialmen are usually involved in large projects; they deal in turn with innumerable sub-materialmen and laborers. To impose unlimited liability under the payment bond to those sub-materialmen and laborers is to create a precarious and perilous risk on the prime contractor and his surety.”).

\textsuperscript{16} Id. at 109.

\textsuperscript{17} Id.

\textsuperscript{18} 40 U.S.C. § 3133(b)(3)(B) (filing in the name of the United States and in the district court for the area where the subcontractor provided the labor or services); 40 U.S.C. § 3133(b)(4) (“An action brought under this subsection must be brought no later than one year after the day on which the last of the labor was performed or material was supplied by the person bringing the action.”). See also United States for Use and Benefit of Harvey Gulf Int’l Marine Inc. v. Maryland Cas. Co., 573 F.2d 245 (5th Cir. 1978) (noting that the venue provision is intended to benefit the defendant and is strictly construed); United States for Use and Benefit of Statham Instruments, Inc. v. Western Cas. & Sur. Co., 359 F.2d 521 (6th Cir. 1966) (suit within one year a condition precedent of the right to bring suit).

\textsuperscript{19} 40 U.S.C. § 3133(b)(2)(A)-(B). Notice to the surety is generally not required. See Cont’l Cas. Co. v. United States for Use and Benefit of Robertson Lumber Co., 305 F.2d 794 (8th Cir. 1962).

\textsuperscript{20} See, for example, United States for Use of John D. Ahern Co., Inc. v. J.F. White Contracting Co., 649 F.2d 29 (1st Cir. 1981) (notice a condition precedent to the existence of a right of action on the bond); Nat’l Union Indem. Co. v. R.O. Davis, Inc., 393 F.2d 897 (5th Cir. 1968) (recovery may be precluded when proper notice is not given).

\textsuperscript{21} See, for example, W.F. Magann Corp. v. Diamond Mfg. Co., Inc., 775 F.2d 1202 (4th Cir. 1985) (awarding the subcontractor damages in quantum meruit); United States v. Algernon Blair, Inc., 479 F.2d 638 (4th Cir. 1973) (same).

\textsuperscript{22} 40 U.S.C. § 3133(c)(1)-(3).
government. However, the subcontractor cannot recover from the government for the prime contractor’s failure to obtain a bond or its failure to obtain a sufficient bond.

The Prompt Payment Act

Enacted in response to agencies’ widely reported delays in paying their bills, the Prompt Payment Act of 1982 generally requires federal agencies to pay interest on any payments they fail to make by the date(s) specified in the contract or within 30 days of receipt of a “proper invoice.” This act originally applied only to payments made by the government to prime contractors, although it encompassed payments under all types of contracts (e.g., manufacturing, construction, service). However, the Prompt Payment Act was amended in 1988 to extend certain payment protections to subcontractors on federal construction contracts, in part, because agencies’ continued practice of paying late created particular difficulties for subcontractors on construction projects. Subcontractors reportedly perform 80% of the work on construction projects, and they generally do not get paid until after the prime contractor has been paid. Without the 1988 amendments, or similar contract terms, prime contractors would generally be free to agree to whatever payment terms they wish with their subcontractors and would not necessarily pay their subcontractors as quickly.

The 1988 amendments require that every construction contract awarded by a federal agency contain clauses obligating the prime contractor to (1) pay the subcontractor for “satisfactory
performance” under the subcontract within seven days of receiving payment from the agency and (2) pay interest on any amounts that are not paid within the proper time frame. The contract must also obligate the prime contractor to include similar payment and interest penalty terms in its subcontracts, as well as require its subcontractors to impose these terms on their subcontractors. This latter provision, requiring subcontractors to impose the terms on their subcontractors, ensures that the payment and interest penalty requirements “flow down” to all tiers of subcontractors. The prime contractors would have obligations to any first-tier subcontractors, who would have obligations to second-tier subcontractors, who would have obligations to third-tier subcontractors, etc.

The 1988 amendments do, however, allow contractors and higher-tier subcontractors to negotiate terms permitting them to retain or withhold payment from subcontractors or lower-tier subcontractors without incurring interest penalties. “Retainage” occurs when a contractor or subcontractor holds back a specified percentage (generally 10%) of each progress payment otherwise due to a subcontractor in order to protect itself against unsatisfactory performance on the remainder of the contract. “Withholding,” in contrast, occurs when a contractor or subcontractor holds back contract amounts because a subcontractor failed to carry out some obligation under the contract or, in some cases, under another contract. Contractors withholding funds under a contract subject to the Prompt Payment Act must generally provide both the procuring agency and the subcontractor with written notification of withholding, and the amount

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30 31 U.S.C. § 3905(b)(1). A subcontractor’s work is satisfactory if the “property and services received conform to the requirements of the contract.” See New York Guardian Mortg. Corp. v. United States, 916 F.2d 1558, 1560 (Fed. Cir. 1990) (relying on the definition of “satisfactory performance” in Office of Management and Budget (OMB) Circular A-125). OMB Circular A-125 instructed agencies on implementing the Prompt Payment Act. It was rescinded after regulations implementing the act were promulgated.

31 31 U.S.C. § 3905(b)(2). The interest is to be computed for the period beginning on the day after the required payment was due and ending on the date on which payment is made. The interest rate is that determined by the Secretary of the Treasury. See supra note 26.

32 31 U.S.C. § 3905(c). If a subcontractor fails to include the required clauses in subsequent subcontracts, the courts will generally “read in” the clauses, treating them as if they were express terms of the contract, for purposes of administering a remedy. The reading-in of the payment and interest penalty provisions follows the Christian Doctrine, which permits courts to read in certain contract clauses that are required by law, but that the parties neglected to include. See G.L. Christian & Assoc. v. United States, 375 U.S. 954 (1963) (reading the standard termination for convenience clause into a government contract from which it was lacking). The Christian Doctrine does not, however, permit the “automatic incorporation of every required contract clause.” Gen. Eng’g & Mach. Works v. O’Keefe, 991 F.2d 775, 779 (Fed. Cir. 1993). Rather, the Christian Doctrine applies only to “mandatory contract clauses which express a significant or deeply ingrained strand of public procurement policy.” Id.

33 31 U.S.C. § 3905(d)(1)-(3) (“The clauses required by subsections (b) and (c) of this section shall not be construed to impair the right of a prime contractor or a subcontractor at any tier to negotiate, and to include in their subcontract, provisions which—(1) permit the prime contractor or a subcontractor to retain (without cause) a specified percentage of each progress payment otherwise due to a subcontractor for satisfactory performance under the subcontract … (2) permit the contractor or subcontractor to make a determination that part or all of the subcontractor’s request for payment may be withheld in accordance with the subcontract agreement.”). Although not expressly mentioned in statute, defendants in Miller Act suits may similarly plead that they “set off” payments for retainage or withholding. See United States for Use and Benefit of Kashulines v. Thermo Contracting Corp., 437 F. Supp. 195 (D.N.J. 1976).


35 See, for example, Imperial Excavating & Paving, LLC v. Rizzetto Constr. Mgmt., Inc., 935 A.2d 557 (Pa. Super. Ct. 2007) (contractor withholding $262,330 in payments from a subcontractor under one contract because of problems with work under another contract that were not discovered until after payment on that contract had been made). The federal government has separate statutory authority to withhold payment from prime contractors that fail to pay their employees.
withheld cannot exceed the amount specified in this notice.\textsuperscript{36} Contracting parties often agree to retainage and withholding in order to encourage timely completion of the contract and ensure full understanding between the parties regarding the terms of completion.

Because the payment and interest clauses of the contract apply only to the parties, the federal government’s obligations run only to the prime contractor.\textsuperscript{37} Prime contractors have the duty to pay subcontractors, and subcontractors have the duty to pay lower-tier subcontractors. The federal government cannot be interpleaded as a party to any disputes between contractors and subcontractors over late payments or interest.\textsuperscript{38} Contractors’ obligations to pay subcontractors also cannot be passed on to the federal government in any way, including by contract modifications or cost-reimbursement claims.\textsuperscript{39}

The Small Business Act

Amendments made to the Small Business Act in 1978 established the “Small Business Subcontracting Program,” a program designed to benefit certain prospective subcontractors on federal prime contracts.\textsuperscript{40} The requirements of this program vary depending upon the anticipated value of the contract. Contracts valued at over $150,000 and performed within the United States must generally include two clauses pertaining to subcontracting with small businesses.\textsuperscript{41} The first of these clauses articulates federal policies regarding subcontracting with small businesses and timely payment of subcontractors:

\begin{quote}
It is the policy of the United States that small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans, qualified HUBZone small business concerns, small businesses owned and controlled by socially and economically disadvantaged individuals, and small business concerns owned and controlled by women shall have the maximum practicable opportunity to participate in the performance of contracts let by any Federal agency, including contracts and subcontracts for subsystems, assemblies, components, and related services for major systems. It is further the policy of the United States that its prime contractors establish procedures to ensure the timely payment of amount[s] due pursuant to the terms of their subcontracts with small business concerns, small business concerns owned and controlled by veterans, small business concerns owned and controlled by service-disabled veterans,
\end{quote}

\textsuperscript{36} 31 U.S.C. § 3905(e)(1). A proper written notice must generally include the amount to be withheld; the specific causes for withholding under the terms of the subcontract; and the remedial actions to be taken by the subcontractor in order to receive payment of the amounts withheld. 31 U.S.C. § 3905(g)(1)-(3). When withholding, the contractor must also deduct the amount withheld from the progress payment otherwise due to the subcontractor, pay the subcontractor “as soon as practicable” after correction of the deficiency, notify the government of the amount of the reduction, and pay interest on the withheld amount from the eighth day after receipt of such funds from the government. 31 U.S.C. § 3905(e)(1)-(6).

\textsuperscript{37} See, for example, 31 U.S.C. § 3905(k) (“A contractor’s obligation to pay an interest penalty to a subcontractor pursuant to the clauses included in a subcontract under subsection (b) or (c) of this section may not be construed to be an obligation of the United States for such interest penalty.”).

\textsuperscript{38} 31 U.S.C. § 3905(i) (“[A] dispute between a contractor and subcontractor relating to … section (b) or (c) of this section does not constitute a dispute to which the United States is a party.”).

\textsuperscript{39} 31 U.S.C. § 3905(k).


\textsuperscript{41} 15 U.S.C. § 637(d)(2)-(3).
qualified HUBZone small business concerns, small businesses owned and controlled by socially and economically disadvantaged individuals, and small business concerns owned and controlled by women.42

The second of these clauses embodies the contractor’s agreement to carry out the aforementioned policy “to the fullest extent consistent with the efficient performance of this contract,” as well as cooperate in any studies necessary to determine the extent of its compliance.43

Contracts in excess of $650,000 ($1.5 million for construction contracts) that offer subcontracting possibilities generally must also incorporate a subcontracting plan that includes the following:

- “[s]eparate percentage goals” for subcontracting with small businesses, veteran-owned small businesses, service-disabled veteran-owned small businesses, Historically Underutilized Business (HUB) Zone small businesses, small disadvantaged businesses, and women-owned small businesses;
- a statement of the total dollars planned to be subcontracted and the total dollars planned to be subcontracted to small businesses;
- an identification of the principal types of supplies and services to be subcontracted; and
- assurances that the contractor will (1) include terms relating to the government’s policy of promoting contracting with small businesses in all subcontracts that offer subcontracting opportunities and (2) require all subcontractors receiving subcontracts valued in excess of $650,000 ($1.5 million for construction) that are not themselves small businesses to adopt their own subcontracting plans. 44

Contractors on these “larger” contracts are also required by Small Business Administration (SBA) regulations to provide pre-award written notification to unsuccessful small business offerors on all subcontracts valued at over $100,000 for which a small business concern received a preference.45 This notification must include the name and location of the apparently successful offeror and its small business status, if any.46 “Large” prime contractors are encouraged, but not required, to provide similar notice to offerors for subcontracts valued at less than $100,000.47

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42 15 U.S.C. § 637(d)(3)(A). Regulations promulgated under the authority of this act, however, qualify the “maximum practicable opportunity to participate in contract performance” by adding “consistent with its efficient performance.” 48 C.F.R. § 19.702. The “timely payment” provided for here refers to the payment terms of the subcontract, not the requirements of the Prompt Payment Act. Id.
44 48 C.F.R. § 19.704(a)(1)-(11). Prospective contractors that are not themselves small businesses are generally required to submit a proposed subcontracting plan as part of their bid or offer, and agencies may not find a contractor affirmatively “responsible” for purposes of the award of a federal contract unless it agrees to a plan that is also acceptable to the agency. See 48 C.F.R. § 19.705-4. As an alternative to the plans described here, contractors may establish “master plans” that contain similar elements and are valid for three years, or “commercial plans,” which apply to the entire production of commercial items sold by the entire company or a portion of it, in the case of contractors furnishing commercial items. 48 C.F.R. § 19.704(d).
45 13 C.F.R. § 125.3(c)(v). The regulations here explicitly reference “$100,000,” and not the “simplified acquisition threshold” (SAT). The SAT was $100,000 until October 1, 2010, when it was increased to $150,000 to reflect inflation.
46 Id.
47 13 C.F.R. § 125.3(c)(vi) (also referencing “$100,000,” and not the SAT).
The contracting officer has substantial discretion in determining whether particular contracts require a subcontracting plan, and the percentage goals for particular contracts need not correspond to the procuring activities’ goals for the percentage of contract and/or subcontract dollars awarded to various categories of small businesses. However, any subcontracting plan that is required constitutes a material part of the contract, potentially allowing the contractor to be terminated for default if it fails to substantially perform in accordance with the requirements of the plan. Additionally, the contract must include a clause requiring the contractor to pay liquidated damages of an “amount equal to the actual dollar amount by which the contractor failed to achieve each subcontracting goal” if the contractor fails to make a good faith effort to comply with the plan. Agencies are also required to consider contractors’ performance vis-à-vis their subcontracting plans when evaluating their past performance, determining whether prospective contractors are responsible, and making source selection decisions in negotiated procurements.

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48 48 C.F.R. § 19.705-2. Neither the Small Business Act nor regulations promulgated under its authority define the scope of the contracting officer’s discretion here. However, contracting officers have historically been granted broad discretion to utilize the powers granted to them by Congress. See, for example, Precision Std., Inc. v. United States, 228 F. App’x 980, 982 (Fed. Cir. 2007) (holding that contracting officers have broad discretion in responsibility determinations); Night Vision Corp. v. United States, 469 F.3d 1369, 1375 (Fed. Cir. 2006) (noting that contracting officers have broad discretion “to execute and amend contracts, administer contractual performance and decide contractual claims”); E.W. Bliss Company v. United States, 77 F.3d 445, 449 (Fed. Cir. 1996) (holding that contracting officers have broad discretion in their evaluation of bids when awarding contracts).

49 See, for example, B.H. Aircraft Co., Inc., Comp. Gen. Dec. B-295399.2 (July 25, 2005) (denying a protest that alleged, in part, that the Defense Logistics Agency (DLA) improperly agreed to a small business subcontracting goal in a contracting plan that was lower than the overall DLA goal). There are government-wide and agency-specific goals for the percentage of federal contract and/or subcontract dollars awarded to various categories of small businesses. See 15 U.S.C. § 644(g)(1)-(2). The government-wide goal is that 23% of all contract dollars be awarded to small businesses; 3% of all contract and subcontract dollars be awarded to service-disabled veteran-owned small businesses; 3% of all contract dollars be awarded to Historically Underutilized Business (HUB) Zone small businesses; 5% of all contract and subcontract dollars be awarded to small businesses owned and controlled by socially and economically disadvantaged individuals; and 5% of all contract and subcontract dollars be awarded to women-owned small businesses. 15 U.S.C. § 644(g)(1). The agency-specific goals are generally the same as the government-wide ones. See Small Bus. Admin., FY2009 Plan Scorecard Summary, available at http://www.sba.gov/idc/groups/public/documents/sba_homepage/scorecard_2009.html (listing percentage goals for various agencies for FY2008). There are no government-wide or agency-specific goals for subcontracting with veteran-owned small businesses.


51 When the contractor’s performance is defective, the procuring activity may generally reject the defective supplies or services, reduce the contract price, or terminate the contract for default. See John Cibinic, Jr., Ralph C. Nash, & James F. Nagle, Administration of Government Contracts 815-27, 850-63 (4th ed. 2006).

52 48 C.F.R. § 19.705-7(b). See also 15 U.S.C. § 637(d)(4)(F); 48 C.F.R. § 19.702(c). Liquidated damages are damages whose amount was agreed upon, as compensation for specific breaches, by the parties at the time of the contract’s formation.

53 Contractors can generally avoid having to pay such damages because the Federal Acquisition Regulation defines “[f]ailure to make a good faith effort” as including only “willful or intentional failure to perform in accordance with the requirements of the subcontracting plan, or willful or intentional action to frustrate the plan.” 48 C.F.R. § 19.701. Good faith can be shown even if the contractor does not achieve all the goals established in the contract provided that it either exceeds one goal by an amount that it at least equal to any deficiency on another goal or takes certain steps, such as breaking contract work-items into economically feasible units to facilitate small business participation or conducting market research to identify small business contractors and subcontractors. 48 C.F.R. § 125.3(d). Compliance is determined based on on-site reviews conducted 12 months after contract award and follow-up reviews conducted 6 to 8 months after the initial review. 48 C.F.R. § 125.3(f); 13 C.F.R. § 125.3(f).

54 48 C.F.R. § 15.304(c).

55 48 C.F.R. § 19.705-5(a)(1). Firms must be determined to be affirmatively responsible before receiving each federal contract. For more on responsibility determinations, see generally, CRS Report R40633, Responsibility Determinations (continued...
If such percentage goals were not contained in the subcontracting plan, prime contractors would generally be free to subcontract with whomever they wish, and various categories of small businesses would not necessarily have this opportunity to obtain federal contract dollars. However, although subcontracting plans are intended to benefit small businesses, these businesses are not parties to the contract between the government and the contractor, and they generally cannot enforce its terms against the prime contractor.\(^5\) Only the government may generally do so.

### Proposed Legislation

Members of the 111\(^{th}\) Congress have introduced several bills that would expand the legal protections for subcontractors on federal prime contracts.

The Subcontractor Fairness Act (H.R. 4134) would require that offerors for all solicitations for competitively awarded contracts in excess of $550,000 ($1 million for construction) enter into subcontracting agreements for each subcontract expected to be awarded in the performance of the contract.\(^5\) The subcontracting agreements would include the subcontractor’s name, the scope of the work to be performed, and the dollar amount of the contract, and the act provides that such agreements would become valid subcontracts upon award of the prime contract.\(^5\) Sponsors of the legislation reportedly seek to prevent contractors from engaging in a process of “bait-and-switch,” undertaking “preliminary discussion and work with small subcontractors in order to increase their chances of securing the contract award” and then eliminating such subcontractors “once the prime contractor secures the bid.”\(^6\) It is unclear, however, whether courts would construe such agreements to be binding contracts where other requirements of a binding contract, most notably mutuality of assent, are lacking.

The Small Business Contracting Revitalization Act (S. 2989) would amend Section 8(d) of the Small Business Act, which is the basis for the Small Business Subcontracting Program described above, to require that all contractors with subcontracting plans notify the contracting officer in writing if they pay a reduced price to a subcontractor or if payment is more than 90 days past

\(^{...continued}\)

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\(^{56}\) 48 C.F.R. § 19.1202-3; 48 C.F.R. § 15.304(c)(iii); 13 C.F.R. § 125.3(g). While agencies generally have “broad discretion” in selecting evaluation factors, they must include a factor to “evaluate past performance indicating the extent to which the offeror attained applicable goals for small business participation under contracts that required subcontracting plans.” Id.

\(^{57}\) There does not appear to be any published federal case in which a small business attempted to assert that it was a third party beneficiary of the subcontracting plan in a government contract. See, for example, Ralte v. Helen Keller Int’l, Inc., 1998 U.S. App. LEXIS 6573, at *8 n.3 (noting that the plaintiff did not allege that she was a third-party beneficiary of the contract in whose subcontracting plan she was listed).

\(^{58}\) H.R. 4134, § 2(a) (contracts of civilian agencies) & 2(d) (contracts of defense agencies).

\(^{59}\) Id.

\(^{60}\) See, for example, Rep. Yvette D. Clarke Co-Authors the Subcontractor Fairness Act of 2009, available at http://clarke.house.gov/2009/11/rep-yvette-d-clarke-co-authors-the-subcontractor-fairness-act-of-2009.shtml. In March 24, 2010, hearing before the House Committee on Small Business, Linda Hillmer, president and CEO of CorpComm Inc., stated that “[T]here are large businesses that have a reputation for using small businesses to meet small business goals to win the initial award. Upon award, they either never allow the small businesses to work or initially award them work but slowly ease the small businesses out by taking the positions, sometimes even hiring the sub’s employees.” Written Testimony before the U.S. House of Representatives Committee on Small Business, available at http://www.house.gov/smbiz/hearings/hearing-03-24-10-federal-contracting/Hillmer.pdf.
due. The notice would include the reasons for the reduction in payment or failure to pay, and the agency would make the notice publicly available after redacting any information identifying the subcontractor. Agencies would also be required to consider the prime contractor’s failure to make full or timely payment when evaluating its performance, which could limit its ability to obtain future contracts. Additionally, the contracting officer would be authorized to restrict the ability of prime contractors with a history of untimely payments to “make expenditures under or control payment of subcontractors for a covered contract.”

The Expanding Opportunities for Main Street Act of 2010 (H.R. 4929) would require that agencies withhold certain amounts or percentages of the contract price from contractors who fail to achieve their goals for subcontracting with small businesses owned and controlled by socially and economically disadvantaged individuals. It would also require that agency contracts include terms obligating the contractor to provide a written justification to the agency whenever it does not enter into a subcontract with a specific small business identified in its subcontracting plan or substitutes another subcontractor for that small business.

The Small Business Bill of Rights (H.R. 5109) would similarly require that the SBA promulgate regulations to govern its review of subcontracting plans, “including the standards for determining good faith compliance with subcontracting plans.” However, the bill does not explain whether or how any standards promulgated would differ from the existing ones.

Finally, the National Defense Authorization Act for FY2011 (H.R. 5136) would require the Department of Defense to conduct regular performance assessments of the defense acquisition system. The metrics to be created for conducting such assessments are to include, among other things, contractor performance in subcontracting with small businesses.

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61 S. 2989, § 304.
62 Id. The act does not specify how the agency is to make notices publicly available. Notice would appear to be required regardless of whether the prime contractor retained or withheld payment, as is permissible under the Prompt Payment Act, for defective performance of the subcontractor or for other reasons.
63 Id.
64 See, for example, 48 C.F.R. § 42.1501 (“Past performance information is relevant information, for future source selection purposes, regarding a contractor’s actions under previously awarded contracts.”).
65 S. 2989, § 304.
66 H.R. 4929, § 205. The amount of withholding would vary with the contract price, ranging from $5,000, in the case of contracts for $100,000 or less, to 3% of the contract amount, in the case of contracts valued at between $100,000 and $5 million, to 5% of the contract amount, in the case of contracts valued at $5 million or more.
67 Id.
68 H.R. 5109, § 1031.
69 Currently, the SBA considers the following three factors in determining whether the contractor has made good faith efforts to comply with its subcontracting plan: (1) taking one of several steps recognized in the regulations, such as breaking work into smaller units, conducting market research, etc.; (2) overachieving one goal by an amount equal to or greater than the amount by which it failed to achieve another goal; and (3) fulfilling all requirements of the plan. See 13 C.F.R. § 125.3(d).
70 H.R. 5136, Title I, § 101.
71 Id.
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