Legal Protections for Subcontractors on Federal Prime Contracts

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Summary

Payment and other protections for subcontractors on federal contracts are of perennial interest to Members and committees of Congress, in part, because many subcontractors are small businesses, and it 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.” Subcontractors on federal contracts are not in privity of contract with the government and would generally lack the payment and other protections that federal prime contractors enjoy. However, Congress has enacted several measures that give small business and other subcontractors certain protections. Key among these are the Miller Act, the 1988 amendments to the Prompt Payment Act, and Section 8(d) of the Small Business Act.

The Miller Act of 1935, as amended, 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 the government 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 generally 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. However, the federal government cannot be interpleaded as a party to any disputes between contractors and subcontractors over late payments or interest, and contractors’ obligations to pay subcontractors cannot be passed on to the federal government in any way, including by contract modifications or cost-reimbursement claims.

Section 8(d) of the Small Business Act provides a different sort of protection for prospective subcontractors by generally requiring that prime contractors agree to plans for subcontracting some percentage of the work to be performed under federal contracts with various types of small businesses. Without such subcontracting plans, or similar contract terms, prime contractors would generally 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. The 111th Congress amended Section 8(d) to require that prime contractors with subcontracting plans make a “good faith effort” to work with the subcontractors whom they “used” in preparing their bids or proposals, and provide the contracting officer with a written explanation whenever they fail to do so (P.L. 111-240, §1322). The 2010 amendments also require that prime contractors notify the contracting officer in writing whenever they pay a “reduced price” to a subcontractor for completed work, or payment is more than 90 days past due (P.L. 111-240, §1334). The Small Business Administration is in the process of implementing these provisions of the 2010 act.
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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. Payment and other protections for subcontractors on federal contracts are of perennial interest to Members and committees of Congress, in part, because many subcontractors are small businesses, and it 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.”

A separate report, CRS Report R42390, Federal Contracting and Subcontracting with Small Businesses: Issues in the 112th Congress, by Kate M. Manuel and Erika K. Lunder, discusses recently enacted or introduced legislation pertaining to small business subcontractors.

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 government. The subcontractor’s contract is with the prime contractor, as is the government’s
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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 potentially could with a private construction project. 7

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. 8 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, 9 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. 10

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. 11 However, “[e]very person,” as used here, includes only first- and second-tier subcontractors. 12 Lower-tier subcontractors are excluded, we could 13 as are “materialmen” or other parties who supply materials or labor without a contract. 14 These exclusions are partly based on policy considerations

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and partly based on the definition of “subcontractor.” Prime contractors would have greater difficulties in 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. 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.” The term “thus exclude[s] ordinary laborers and materialmen.”

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. 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. Failure to provide proper notice may bar recovery from either the prime contractor or the surety. 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. 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.

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
government. However, the subcontractor cannot recover from the government for the prime contractor’s failure to obtain a bond\textsuperscript{23} or its failure to obtain a sufficient bond\textsuperscript{24}

\textbf{The Prompt Payment Act}

Enacted in response to agencies’ widely reported delays in paying their bills,\textsuperscript{25} the Prompt Payment Act of 1982, as amended, 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.”\textsuperscript{26} 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,\textsuperscript{27} in part, because agencies’ continued practice of paying late created particular difficulties for subcontractors on construction projects.\textsuperscript{28} 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.\textsuperscript{29} 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

\textsuperscript{23} See, e.g., Arvanis v. Noslo Eng’g Consultants, Inc., 738 F.2d 1287, 1289-90 (7th Cir. 1984) (“Appellants argue that the Miller Act requires the government to insist that its contractors furnish Miller Act payment bonds. This is incorrect. The statute requires only that contractors obtain performance and payment bonds. The statute places no affirmative obligation on the government, and says absolutely nothing about what happens when the contractor fails to furnish the bond.”).

\textsuperscript{24} See, e.g., Automatic Sprinkler Corp. of Am. v. Darla Environmental Specialists Inc., 53 F.3d 181, 182 (7th Cir. 1995) (denying recovery from the government when the bonds were found to be insufficient because the prime contractor had failed to properly qualify the bond securities); United States for Use and Benefit of Gulf States Enters., Inc. v. R.R. Tway, Inc., 938 F.2d 583 (5th Cir. 1991) (remedies can only be obtained from parties having a direct contractual relationship with the subcontractor). Although the United States must be named as a party to the suit, it has no actual financial interest involved. See United States ex rel. Haycock v. Hughes Aircraft Co., 98 F.3d 1100 (9th Cir. 1996).


\textsuperscript{26} P.L. 97-177, 96 Stat. 85 (May 21, 1982) (codified, as amended, at 31 U.S.C. §§3901-3907). Among other things, a proper invoice contains (1) the name of the contractor, the invoice date, and the contract number; (2) a description of the goods rendered and the shipping and payment terms; (3) other substantiating documentation or information required under the contract; and (4) the name, title, telephone number, and complete mailing address of the person to whom payment should be sent. 31 U.S.C. §3901(a); 48 C.F.R. §32.905(b)(1)(i)-(x). The interest rate to be used is that determined by the Secretary of the Treasury twice a year under the Contract Disputes Act. See 31 U.S.C. §3902(a).

\textsuperscript{27} Prompt Payment Act Amendments of 1988, P.L. 100-496, §9, 102 Stat. 3460-63 (October 17, 1988) (codified at 31 U.S.C. §3905(b)(1)-(2)).


\textsuperscript{29} See, e.g., H.Rept. 100-784, at 26 (percentage of work on federal construction contracts performed by subcontractors); S.Rept. 100-78, at 23 (same).
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 withheld cannot exceed the amount specified in this notice. Contracting parties often agree to

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.


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, e.g., 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).

36 31 U.S.C. §3905(c)(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).
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. 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, and 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.

Obama Administration Payment Policies

The Obama Administration recently issued guidance that supplements the requirements of the Prompt Payment Act as to the payment of small business contractors and subcontractors. Initially, this guidance called for agencies to pay small business contractors within 15 days of receipt of a proper invoice. However, subsequent guidance sought to address payment of small business subcontractors by calling for agencies to “temporarily accelerate payments to all prime contractors, in order to allow them to provide prompt payments to small business subcontractors.” The Administration characterizes this as a “temporary policy,” and contemplates developing a standard clause for inclusion in agencies’ prime contracts that would generally oblige the prime contractor to promptly pay its small business subcontractors. The current clauses regarding prompt payment of subcontractors on construction contracts are specifically noted as potential models for the proposed clause. However, agencies would not be required to pay interest on any payments that are not made within the proposed time frames, unlike with “late” payments under the Prompt Payment Act.

See, e.g., 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.”).

31 U.S.C. §3905(k) (“[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.”).


The memorandum provides for acceleration of payments to a prime contractor, in particular, to last for one year. Id.

Cf. 48 C.F.R. §52.232-27(c) (“The Contractor shall include in each subcontract for property or services ... for the purpose of performing this contract the following: (1) ... A payment clause that obligates the Contractor to pay the subcontractor for satisfactory performance under its subcontract not later than 7 days from receipt of payment out of such amounts as are paid to the Contractor under this contract. (2) ... An interest penalty clause that obligates the Contractor to pay to the subcontractor an interest penalty for each payment not made in accordance with the payment clause ...”).
The Small Business Act

Amendments made to Section 8(d) of the Small Business Act in 1978 established the “Small Business Subcontracting Program,” a program designed to benefit certain prospective subcontractors on federal prime contracts. 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. The first of these clauses articulates federal policies regarding subcontracting with small businesses and timely payment of subcontractors:

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, 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.

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.

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

46 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.
• 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. 48

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. 49 This notification must include the name and location of the apparently successful offeror and its small business status, if any. 50 “Large” prime contractors are encouraged, but not required, to provide similar notice to offerors for subcontracts valued at less than $100,000. 51

The contracting officer has substantial discretion in determining whether particular contracts require a subcontracting plan, 52 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. 53 However, any subcontracting plan that is required constitutes a material part of the contract, 54 potentially allowing the contractor to be terminated for default if it fails to substantially perform in accordance with the requirements of

48 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(b) & (d).

49 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.

50 Id.

51 13 C.F.R. §125.3(c)(vi) (also referencing “$100,000,” and not the SAT).

52 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, e.g., 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).

53 See, e.g., 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 and subcontract 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 Business Goaling Report: Fiscal Year 2011, available at https://www.fdpds.gov/downloads/top_requests/FDPDSNG_SB_Goaling_FY_2011.pdf. The report on FY2012 has not yet been compiled. There are no government-wide or agency-specific goals for contracting or subcontracting with veteran-owned small businesses.

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.

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. Only the government may generally do so.

### 2010 Amendments to the Small Business Act

The 111th Congress expanded the payment and other protections for small business subcontractors under Section 8(d) of the Small Business Act when it enacted the Small Business Jobs Act of 2010. Among other things, this act requires that prime contracts incorporating subcontracting plans also include terms obligating the contractor to

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55 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).

56 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.

57 Contractors often avoid having to pay such damages because the Federal Acquisition Regulation defines “[f]ailure to make a good faith effort” to mean a “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 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. 13 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. 13 C.F.R. §125.3(f).

58 48 C.F.R. §15.304(c).

59 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 Under the Federal Acquisition Regulation: Legal Standards and Procedures, by Kate M. Manuel.

60 48 C.F.R. §19.1202-3; 48 C.F.R. §15.304(c); 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.” 48 C.F.R. §15.304(c)(3)(ii).

61 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, e.g., 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).

make a good faith effort to acquire articles, equipment, supplies, services, or materials, or obtain the performance of construction work from the small business concerns used in preparing and submitting … the bid or proposal, in the same amount and quality used in preparing and submitting the bid or proposal,

and provide the contracting officer with a written explanation whenever it fails to do so. In addition, the act requires that prime contractors with subcontracting plans notify the contracting officer in writing if they pay a subcontractor a reduced price, or if payment is more than 90 days past due on a contract for which the federal agency has paid the prime contractor. The Small Business Jobs Act also requires that contracting officers consider any “unjustified failure” by a prime contractor to make full or timely payments to a subcontractor in evaluating the contractor’s performance, and note any “history” of unjustified failures to make full or timely payment in the Federal Awardee Performance and Integrity Information System (FAPIIS).

The SBA has proposed regulations that would implement these provisions of the Small Business Jobs Act. Among other things, SBA would: (1) define “subcontract” so as to exclude electricity and utilities, among other things, from the “subcontracting base” that is used in measuring contractors’ performance in subcontracting; (2) authorize contracting officers to establish subcontracting goals reported as a percentage of total contract dollars (as well as a percentage of total subcontracting dollars); and (3) specify when a contractor could be said to have “used” a small business in preparing a bid or proposal. Under the proposed regulations, the latter circumstances would be fairly narrowly defined, encompassing only situations where the offeror specifically referenced a particular small business in its bid or proposal or entered into a written agreement with the small business for purposes of performing the specific contract as a subcontractor, or where the small business drafted portions of the proposal, or submitted pricing or technical information that appears in the bid or proposal, with the intent or understanding that the small business would perform that related work if the offeror is awarded a contract. The SBA has also requested comments upon whether prime contractors who fail to meet their obligations in paying subcontractors should be required to enter into “funds control agreements” with third parties.

In part because SBA has not finalized these regulations, it remains to be seen to what degree the Small Business Jobs Act may address the payment-related and other concerns of small business
subcontractors. Given the SBA’s proposed regulations, some concerns could potentially persist, in part, because SBA expressly declined to adopt several findings or recommendations that the Government Accountability Office (GAO) has made for improving small business subcontracting. Specifically, while GAO found that certain contractors had overstated their small business subcontracting achievements by excluding certain contracts, such as those for electricity and utilities, from the base, SBA would exclude electricity and utility costs, among other things, when determining the amount available for subcontracting. Similarly, while GAO recommended that prime contractors report their performance in subcontracting with small businesses as a percentage of total contract dollars (not subcontract dollars), SBA would continue to authorize reporting of subcontracting performance as a percentage of subcontract dollars. In addition, as the preamble to the proposed regulation notes, “[d]efining when a prime used a subcontractor in preparing a bid or proposal is very difficult,” and some subcontractors may feel that they were “used” in preparing a bid or proposal notwithstanding the fact that their situations are not addressed by the regulations.

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72 76 Federal Register at 61628.